96th Annual Report 2009

Board of Governors of the Federal Reserve System

This publication is available from the Board of Governors of the Federal Reserve System, Publications Fulfillment, Washington, DC 20551. It is also available on the Board's website, at www.federalreserve.gov.

Letter of Transmittal

Board of Governors of the Federal Reserve System
Washington, D.C.

May 2010

The Speaker of the House of Representatives:

Pursuant to the requirements of section 10 of the Federal Reserve Act, I am pleased to submit the ninety-sixth annual report of the Board of Governors of the Federal Reserve System.

This report covers operations of the Board during calendar year 2009.

Sincerely,

Ben Bernanke
Chairman

Overview

The Federal Reserve, the central bank of the United States, is a federal system composed of a central governmental agency—the Board of Governors—and 12 regional Federal Reserve Banks.

The Board of Governors, located in Washington, D.C., consists of seven members appointed by the President of the United States and supported by a 2,100-person staff. Besides conducting research, analysis, and policymaking related to domestic and international financial and economic matters, the Board plays a major role in the supervision and regulation of the U.S. banking system and administers most of the nation's laws regarding consumer credit protection. It also has broad oversight responsibility for the nation's payments system and the operations and activities of the Federal Reserve Banks.

This report covers Board and System operations and activities during calendar-year 2009. The report includes six main sections:

- **Monetary Policy and Economic Developments.** Section 1 provides adapted versions of the February 2010 and July 2009 *Monetary Policy Report to the Congress* (see pages 3–95).
- **Federal Reserve Operations.** Section 2 provides summaries of the Board and System activities in the areas of banking supervision and regulation, consumer and community affairs, and Reserve Bank operations. It also summarizes Board compliance with the Government Performance and Results Act of 1993 and its activities regarding legislative developments that affected Board operations in 2009 (see pages 99–207).
- **Records.** Section 3 provides an account of actions taken by the Board on questions of policy in 2009, and it also includes the policy actions of the Federal Open Market Committee (FOMC)[1] during the year, provided pursuant to section 10 of the Federal Reserve Act (see pages 211–392).
- **Federal Reserve System Organization.** Section 4 provides listings of key officials at the Board and in the Federal Reserve System, including the Board of Governors, its officers, FOMC members, several System councils, and Federal Reserve Bank and Branch officers and directors (see pages 395–424).
- **Statistical Tables.** Section 5 includes 14 statistical tables that provide updated historical data concerning Board and System operations and activities (see pages 426–466).
- **Federal Reserve System Audits.** Section 6 provides detailed information on the several levels of audit and

For More Background on Board Operations

For more information about the Federal Reserve Board and the Federal Reserve System, visit the Board's website at www.federalreserve.gov/aboutthefed. An online version of this *Annual Report* is available at www.federalreserve.gov/boarddocs/rptcongress.

1. For more information on the FOMC, see the Board's website at www.federalreserve.gov/monetarypolicy/fomc.htm.

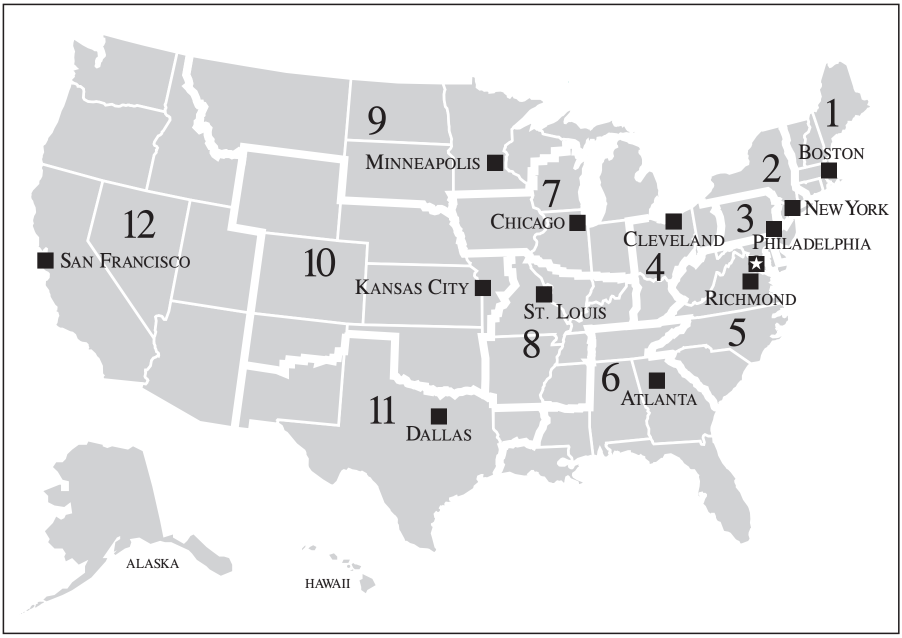
review conducted that concern System operations and activities, including those provided by outside auditors and the Board's Office of Inspector General (see pages 469–544).

The Federal Reserve System

The Federal Reserve System, which serves as the nation's central bank, was created by an act of Congress on December 23, 1913. The System consists of a seven-member Board of Governors with headquarters in Washington, D.C., and the 12 Reserve Banks located in major cities throughout the United States.

The Federal Reserve Banks are the operating arms of the central banking system, carrying out a variety of System functions, including operating a nationwide payments system; distributing the nation's currency and coin; under authority delegated by the Board of Governors, supervising and regulating bank holding companies and state-chartered banks that are members of the System; serving as fiscal agents of the U.S. Treasury; and providing a variety of financial services for the Treasury, other government agencies, and other fiscal principals.

The maps below and opposite identify Federal Reserve Districts by their official number, city, and letter designation. ■



Legend

Both pages

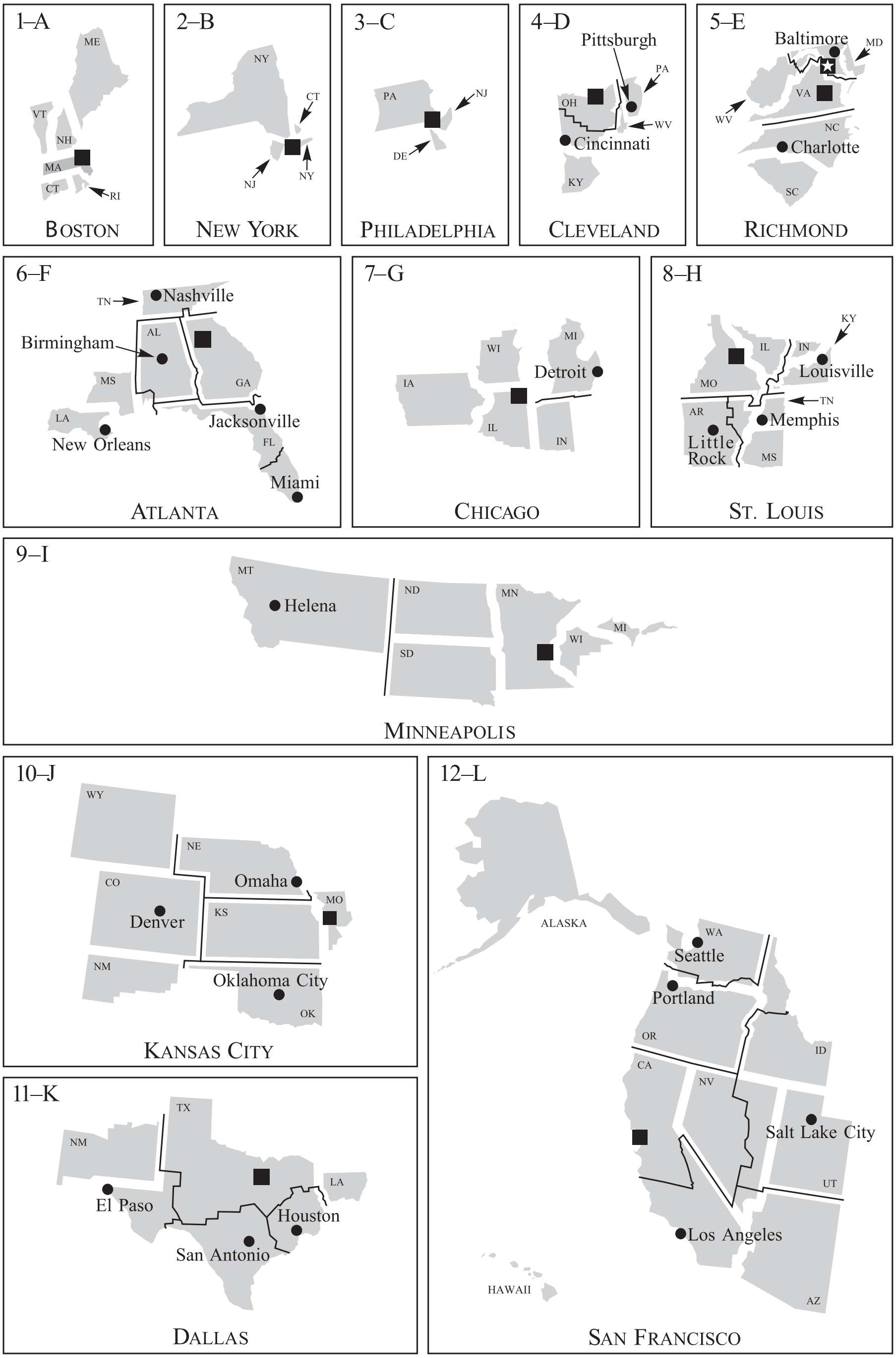
■ Federal Reserve Bank city

☆ Board of Governors of the Federal Reserve System, Washington, D.C.

Facing page

• Federal Reserve Branch city

— Branch boundary


1–A
ME
VT
NH
MA
CT
RI
BOSTON
2–B
NY
CT
NJ
NY
NEW YORK
3–C
PA
NJ
DE
PHILADELPHIA
4–D
Pittsburgh
PA
OH
WV
Cincinnati
KY
CLEVELAND
5–E
Baltimore
MD
VA
WV
NC
Charlotte
SC
RICHMOND
6–F
TN
Nashville
Birmingham
AL
MS
GA
LA
Jacksonville
New Orleans
FL
Miami
ATLANTA
7–G
MI
WI
Detroit
IA
IL
IN
CHICAGO
8–H
KY
IL
IN
Louisville
MO
TN
AR
Memphis
Little Rock
MS
ST. LOUIS
9–I
MT
ND
MN
Helena
MI
WI
SD
MINNEAPOLIS
10–J
WY
NE
CO
Omaha
MO
KS
Denver
NM
Oklahoma City
OK
KANSAS CITY
11–K
TX
NM
LA
El Paso
Houston
San Antonio
DALLAS
12–L
ALASKA
WA
Seattle
Portland
OR
ID
CA
NV
Salt Lake City
UT
Los Angeles
HAWAII
AZ
SAN FRANCISCO

Contents

Monetary Policy and Economic Developments

Federal Reserve Operations

Records

Federal Reserve System Organization

Statistical Tables

Federal Reserve System Audits

Monetary Policy and Economic Developments

Monetary Policy Report of February 2010

Part 1
Overview: Monetary Policy and the Economic Outlook

After declining for a year and a half, economic activity in the United States turned up in the second half of 2009, supported by an improvement in financial conditions, stimulus from monetary and fiscal policies, and a recovery in foreign economies. These factors, along with increased business and household confidence, appear likely to boost spending and sustain the economic expansion. However, the pace of the recovery probably will be tempered by households' desire to rebuild wealth, still-tight credit conditions facing some borrowers, and, despite some tentative signs of stabilization, continued weakness in labor markets. With substantial resource slack continuing to suppress cost pressures and with longer-term inflation expectations stable, inflation is likely to be subdued for some time.

U.S. real gross domestic product (GDP) rose at about a 4 percent pace, on average, over the second half of 2009. Consumer spending—which was boosted by supportive monetary and fiscal policies—posted solid increases, though it remained well below its pre-recession level. Meanwhile, activity in the housing market, which began to pick up last spring, flattened over the second half of 2009. In the business sector, investment in equipment and software posted a sizable gain in the second half of last year, likely reflecting improved conditions in capital markets and brighter sales prospects. In addition, firms reduced the pace of inventory liquidation markedly in the fourth quarter. In contrast, investment in nonresidential structures continued to contract. With the recovery in U.S. and foreign demand, U.S. trade flows rebounded in the second half of 2009 after precipitous declines late in 2008 and early in 2009. Nevertheless, both exports and imports stayed considerably below their earlier peaks.

Despite the pickup in output, employment continued to contract in the second half of 2009, albeit at a markedly slower pace than in the first half. The unemployment rate rose further during the second half, reaching 10 percent by the end of the year—its highest level since the early 1980s—before dropping back in January. Although job losses have slowed, hiring remains weak, and the median duration of unemployment has lengthened significantly.

Headline consumer price inflation picked up in 2009 as energy prices rose sharply: Over the 12 months ending in December, prices for personal consumption expenditures (PCE) increased

---

NOTE: Included in this chapter are the text, tables, and selected figures from the Monetary Policy Report submitted to Congress on February 24, 2010, pursuant to section 2B of the Federal Reserve Act. The figures included here have been renumbered, and therefore the figure numbers in this report differ from the figure numbers in the Monetary Policy Report. The complete set of figures is available on the Board's website at www.federalreserve.gov/boarddocs/hh.

Other materials in this annual report related to the conduct of monetary policy include the minutes of the 2009 meetings of the Federal Open Market Committee (see the "Records" section) and statistical tables 1–4 (see the "Statistical Tables" section).

about 2 percent, up from ½ percent in 2008. In contrast, price increases for consumer expenditures other than food and energy items—so-called core PCE—slowed noticeably last year. After rising at an annual rate of about 1¾ percent in 2008 and the first half of 2009, core PCE prices increased at an annual rate of just over 1 percent in the second half of the year.

The recovery in financial markets that began last spring continued through the second half of the year and into 2010. Broad equity price indexes increased further, on balance, and risk spreads on corporate bonds narrowed considerably. Conditions in short-term funding markets returned to near pre-crisis levels; liquidity and pricing in bank funding markets continued to normalize, while risk spreads in the commercial paper market were stable at the low end of the range observed since the fall of 2007. The functioning of financial markets more generally improved further.

Investors became more optimistic about the outlook for financial institutions during the first half of last year. That development was bolstered by the release of the results of the Supervisory Capital Assessment Program (SCAP), which were seen as helping clarify the financial conditions of the largest bank holding companies and provided investors with greater assurance about the health of the institutions. Sentiment rose further over the remainder of the year as investors became more optimistic about the economic outlook. Most of the 19 bank holding companies included in the SCAP issued equity, some to augment or improve the quality of their capital and some to repay investments made by the Treasury under the Troubled Asset Relief Program. Still, delinquency and charge-off rates at commercial banks increased further in the second half of the year, and loan losses remained very high.

Nonfinancial firms with access to capital markets took advantage of the improvement in financial conditions to issue corporate bonds and equity shares at a solid pace; a significant portion of issuance likely reflected an effort by businesses to substitute attractively priced longer-term financing for shorter-term debt. In contrast, many small businesses and other firms that depend largely on banks to meet their funding needs found their access to credit severely restricted; banks continued to tighten their lending standards and terms, though to a more limited extent, during the second half of 2009 amid higher loan losses on their commercial loans and reports of lingering uncertainty about business credit quality. According to survey data, demand for business loans was also weak throughout 2009.

Availability of credit for households remained constrained in the second half of 2009, even as interest rates declined for mortgages and many consumer loans. Restrictive bank lending policies to individuals likely were due importantly to banks' concerns about the ability of households to repay loans in an environment of high unemployment and continued softness in house prices. In addition, senior bank loan officers reported weakening loan demand from households throughout 2009. However, in part because of support from the Federal Reserve's Term Asset-Backed Securities Loan Facility, the consumer asset-backed securities market, which is an important funding source for consumer loans, improved. All told, in 2009 nominal household debt experienced its first annual decline since the beginning of the data series in 1951.

The Federal Reserve continued to support the functioning of financial markets and promote recovery in economic activity using a wide array of tools. The Federal Open Market Committee (FOMC) maintained a target range of 0 to ¼ percent for the federal funds rate throughout the second half of 2009 and early 2010 and indicated that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period. Further, the Federal Reserve continued its purchases of Treasury securities, agency mortgage-backed securities (MBS), and agency debt in order to provide support to mortgage and housing markets and to improve overall conditions in private credit markets. To promote a smooth transition in financial markets as the acquisitions are completed, the Federal Reserve gradually slowed the pace of these purchases in late 2009 and early 2010. The planned acquisitions of $300 billion of Treasury securities were completed by October, while the purchases of $1.25 trillion of MBS and about $175 billion of agency debt are expected to be finished by the end of the first quarter of this year.

In light of the improved functioning of financial markets, the Federal Reserve removed some of the extraordinary support it had provided during the crisis and closed many of its special liquidity facilities and the temporary liquidity swap arrangements with other central banks in the fall of 2009 and early in 2010. The Federal Reserve also began to normalize its lending to commercial banks through the discount window by reducing the maximum maturity of loans extended through the primary credit facility from 90 days to 28 days, effective on January 14, and by announcing that the maturity of those loans will be reduced further to overnight, effective on March 18. The rate charged on primary credit loans was increased from ½ percent to ¾ percent effective February 19. In addition, the Federal Reserve announced that the final auction under the Term Auction Facility will occur in March and later noted that the minimum bid rate for that auction had been increased by ¼ percentage point to ½ percent. Overall, the size of the Federal Reserve's balance sheet increased from about $2 trillion in the summer of 2009 to about $2.3 trillion on February 17, 2010. The composition of the balance sheet continued to shift as a considerable decline in credit extended through various facilities was more than offset by the increase in securities held outright. The Federal Reserve continued to broaden its efforts to provide even more information to the public regarding its conduct of these programs and of monetary policy (see box in Part 3).

The Federal Reserve is taking steps to ensure that it will be able to smoothly withdraw extraordinary policy accommodation when appropriate. Because the Federal Reserve, under the statutory authority provided by the Congress in October 2008, pays interest on the balances depository institutions hold at Reserve Banks, it can put upward pressure on short-term interest rates even with an extraordinarily large volume of reserves in the banking system by raising the interest rate paid on such balances. In addition, the Federal Reserve has continued to develop several other tools that it could use to reinforce the effects of increases in the interest rate on balances at Reserve Banks. In particular, the Federal Reserve has tested its ability to execute reverse repurchase agreements (reverse repos) in the triparty repo market with primary dealers using both Treasury and agency debt as collateral, and it is developing the capability to conduct such transactions with other counterparties and against agency MBS. The Federal Reserve has also announced plans for implementing a term deposit facility. In addition, it has the option of redeeming or selling assets in order to reduce monetary policy accommodation.

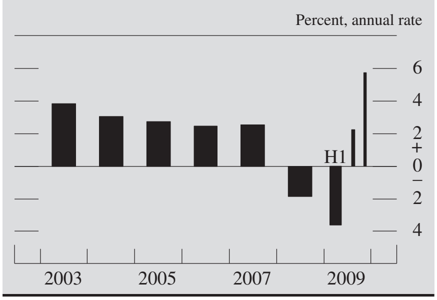
In conjunction with the January 2010 FOMC meeting, the members of the Board of Governors of the Federal Reserve System and presidents of the Federal Reserve Banks, all of whom participate in FOMC meetings, provided projections for economic growth, unemployment, and inflation; these projections are presented in Part 4 of this report. FOMC participants agreed that economic recovery from the recent recession was under way, but that they expected it to proceed at a gradual pace, restrained in part by household and business uncertainty regarding the economic outlook, modest improvement in labor markets, and slow easing of credit conditions in the banking sector. Participants expected that real GDP would expand at a rate that was only moderately above its longer-run sustainable growth rate and that the unemployment rate would decline only slowly over the next few years. Most participants also anticipated that inflation would remain subdued over this period.

Nearly all participants judged the risks to their growth outlook as generally balanced, and most also saw roughly balanced risks surrounding their inflation projections. Participants continued to judge the uncertainty surrounding their projections for economic activity and inflation as unusually high relative to historical norms. Participants also reported their assessments of the rates to which key macroeconomic variables would be expected to converge in the longer run under appropriate monetary policy and in the absence of further shocks to the economy. The central tendencies of these longer-run projections were 2.5 to 2.8 percent for real GDP growth, 5.0 to 5.2 percent for the unemployment rate, and 1.7 to 2.0 percent for the inflation rate.

Part 2 Recent Financial and Economic Developments

According to the advance estimate from the Bureau of Economic Analysis, real gross domestic product (GDP) increased at an annual rate of 4 percent in the second half of 2009, retracing part of the sharp decline in activity that began in early 2008 (figure 1). Nonetheless, labor market conditions, which tend to lag changes in economic activity, remain very weak: The unemployment rate rose to 10 percent at the end of last year, 5 percentage points above its level at the start of 2008, before dropping back some in January. Conditions in many financial markets have improved significantly, but lending policies at banks remain stringent. Meanwhile, an increase in energy prices has boosted overall consumer

1. Change in Real Gross Domestic Product, 2003–09



NOTE: Here and in subsequent figures, except as noted, change for a given period is measured to its final quarter from the final quarter of the preceding period.

SOURCE: Department of Commerce, Bureau of Economic Analysis.

price inflation; however, price inflation for other items has remained subdued, and inflation expectations have been relatively stable.

Conditions in financial markets improved further in the second half of 2009, reflecting a more positive economic outlook as well as the effects of the policy initiatives implemented by the Federal Reserve, the Treasury, and other government agencies to support financial stability and promote economic recovery. Treasury yields, mortgage rates, and other market interest rates remained low while equity prices continued to rise, on net, amid positive earnings news, and corporate bond spreads narrowed substantially. As the functioning of short-term funding markets improved further, the usage of special liquidity facilities declined sharply, and the Federal Reserve closed several of those facilities on February 1, 2010.[1] Investors also seemed to become more optimistic about the prospects for the banking sector, and many of the largest banking institutions issued equity and repaid investments made by the Treasury under the Troubled Asset Relief Program (TARP). Nevertheless, the credit quality of bank loan portfolios remained a concern, particularly for loans secured by commercial and residential real estate loans.

Private domestic nonfinancial sector debt contracted, on balance, in the second half of 2009. On the positive side, firms with access to capital markets issued corporate bonds at a robust pace, with many firms reportedly seeking to lock in long-term, low-interest-rate debt or refinance other debt. By contrast, many small businesses and other firms that depend primarily on banks for their funding needs faced substantial constraints on their access to credit even as demand for such credit remained weak. In the household sector, demand for credit was weak, and supply conditions remained tight, as banks maintained stringent lending standards for both consumer loans and residential real estate loans. However, issuance of asset-backed securities (ABS), which are an important source of funding for consumer loans, strengthened, supported in part by the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF).

Domestic Developments

The Household Sector

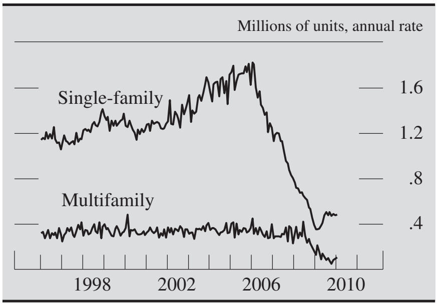
Residential Investment and Housing Finance

The housing market began to recover in the spring of 2009, but the pace of improvement slowed during the second half of the year. After having increased almost 30 percent through mid-2009, sales of new single-family homes retraced about one-half of that gain in the second half of the year. And, although sales of existing single-family homes moved up noticeably through November, they fell back sharply in December, suggesting that some of the earlier strength reflected sales that had been pulled forward in anticipation of the expiration of the first-time homebuyer tax credit.[2] The index of pending

1. Specifically, the Primary Dealer Credit Facility, the Term Securities Lending Facility, the Commercial Paper Funding Facility, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, and the temporary swap lines with foreign central banks were closed.

2. The first-time homebuyer tax credit, which was enacted in February 2009 as part of the American Recovery and Reinvestment Act, was originally scheduled to expire on November 30, 2009. In early November, however, the Congress

2. Private Housing Starts, 1996–2010



NOTE: The data are monthly and extend through January 2010.

SOURCE: Department of Commerce, Bureau of the Census.

home sales, a leading indicator of sales of existing homes, leveled off in December after November's steep decline.

The recovery in construction activity in the single-family sector also decelerated in the second half of 2009. After stepping up noticeably last spring from an exceptionally low level, starts of single-family homes were about flat, on average, from June to December (figure 2). With the level of construction remaining quite low, the inventory of unsold new homes fell sharply and is now less than one-half of the peak reached in 2006. In the much smaller multifamily sector—where tight credit conditions and high vacancies have depressed building—starts deteriorated a bit further in the second half of the year.

After falling sharply for about two and a half years, house prices, as measured by a number of national indexes, were more stable in the second half of 2009. One house price measure with wide geographic coverage—the LoanPerformance repeat-sales index—is up, on net, from its trough earlier in the year, even though the last few readings of that index fell back a bit. According to the Thomson Reuters/University of Michigan Surveys of Consumers, the number of respondents who expect house prices to increase over the next 12 months has moved up and now slightly exceeds the number of respondents who expect prices to decrease.[3] The earlier declines in house prices in combination with the low level of mortgage rates have made housing more affordable, and the apparent stabilization in prices may bring into the market buyers who were reluctant to purchase a home when prices were perceived to be falling. That said, the still-substantial inventory of unsold homes, including foreclosed homes, has continued to weigh on the market.

Even with house prices showing signs of stabilization, home values remained well below the remaining amount of principal on mortgages (so-called underwater loans) for many borrowers in the second half of 2009. Against this backdrop, and with a very high unemployment rate, delinquency rates on all types of residential mortgages continued to move higher. As of December, serious delinquency rates on prime and near-prime loans had climbed to 16 percent for variable-rate loans and to over 5 percent for fixed rate loans.[4] The delinquency rate on all subprime loans was about 35 percent in December. Loans backed by the Federal Housing Administration (FHA) also showed increasing strains, with de-

extended the credit to sales occurring through April 30, 2010, and expanded it to include repeat homebuyers who have owned and occupied a house for at least five of the past eight years.

3. The survey, formerly the Reuters/University of Michigan Surveys of Consumers, was renamed the Thomson Reuters/University of Michigan Surveys of Consumers as of January 1, 2010.

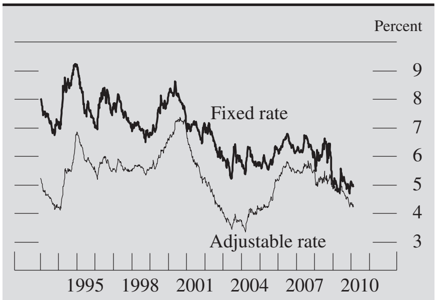
4. A mortgage is defined as seriously delinquent if the borrower is 90 days or more behind in payments or the property is in foreclosure.

linquency rates moving up to 9 percent at the end of 2009.

Foreclosures remained exceptionally elevated in the second half of 2009. About 1.4 million homes entered foreclosure during that period, similar to the pace earlier in the year. Historically, about one-half of foreclosure starts have resulted in homeowners losing the home. The heightened level of foreclosures has been particularly notable among prime borrowers, for whom the number of foreclosure starts moved up a bit in the second half of the year; by contrast foreclosure starts for subprime borrowers dropped back somewhat. To address the foreclosure problem, the Treasury has intensified efforts through its Making Home Affordable program to encourage loan modifications and to allow borrowers to refinance into mortgages with more-affordable payments.

Interest rates on 30-year fixed-rate conforming mortgages moved down in the second half of 2009, and despite a modest upturn around the start of 2010, they remained near the lowest levels on record (figure 3).[5] The low mortgage rates reflected the generally low level of Treasury yields and the large purchases of agency mortgage-backed securities (MBS) by the Federal Reserve, which were reportedly an important factor behind the narrow spread between these conforming mortgage rates and yields on Treasury securities. Interest rates on nonconforming mortgages, which are not included in the mortgage pools backing MBS that are eligible for purchase by the Federal Reserve, also generally declined, but the spreads between nonconforming mortgage rates and rates on conforming mortgages remained wide by historical standards.

3. Mortgage Interest Rates, 1993–2010



NOTE: The data, which are weekly and extend through February 17, 2010, are contract rates on 30-year mortgages.

SOURCE: Federal Home Loan Mortgage Corporation.

Although mortgage rates fell to low levels, the availability of mortgage financing continued to be sharply constrained. Respondents to the Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) indicated throughout 2009 that banks continued to tighten their lending standards for all types of mortgage loans, though smaller net fractions reported doing so in the January 2010 survey than had been the case in earlier surveys. Lenders' reluctance to extend mortgage credit in an environment of declining home values also likely held down refinancing activity, which remained subdued in the second half of 2009 even though mortgage rates decreased. The FHA announced that it was raising mortgage insurance premiums because its capital reserve ratio had fallen below the required threshold; at the same time, the FHA announced that it was

5. Conforming mortgages are those eligible for purchase by Fannie Mae and Freddie Mac; they must be equivalent in risk to a prime mortgage with an 80 percent loan-to-value ratio, and they cannot exceed in size the conforming loan limit. The conforming loan limit for a first mortgage on a single-family home in the contiguous United States is currently equal to the greater of $417,000 or 115 percent of the area's median house price, and it cannot exceed $729,750.

increasing down-payment requirements for borrowers with very low credit scores. In recent years, the FHA has assumed a greater role in mortgage markets, especially for borrowers with high loan-to-value ratios or lower credit quality. Overall, residential mortgage debt outstanding contracted at an even faster pace in the second half than in the first half of the year. Net issuance of MBS by Fannie Mae, Freddie Mac, and Ginnie Mae, although brisk in the second half of 2009, was down a bit from the levels seen earlier in the year. The securitization market for mortgage loans not guaranteed by a housing-related government-sponsored enterprise (GSE) or the FHA remained closed.

Consumer Spending and Household Finance

After having been roughly constant in the first half of last year, real personal consumption expenditures (PCE) rose at an annual rate of about 2½ percent in the second half. Sales of new light motor vehicles jumped from an average annual rate of 9½ million units in the first half of 2009 to a rate of 11¼ million units in the second half.[6] Part of this rebound likely reflected the "cash for clunkers" program, but even after the expiration of that program, sales remained close to 11 million units, supported in part by improved credit conditions for auto buyers as the ABS market revived. Real spending on goods excluding motor vehicles also increased at a robust pace in the second half of the year, while real outlays for services rose more modestly.

The rise in consumer spending in 2009 was buoyed by improvements in some of its underlying determinants: Equity prices moved up from their lows reached last March, a development that helped to rebuild household wealth, and household income was lifted by provisions in the fiscal stimulus package. Accordingly, consumer sentiment has rebounded from the very low levels seen earlier in 2009, though it remains low by historical standards. Consumer spending appears to have been financed largely out of current income over the past year, and households were also able to increase their personal saving and begin deleveraging their balance sheets. After increasing sharply in 2008, the saving rate moved up a bit further in 2009.

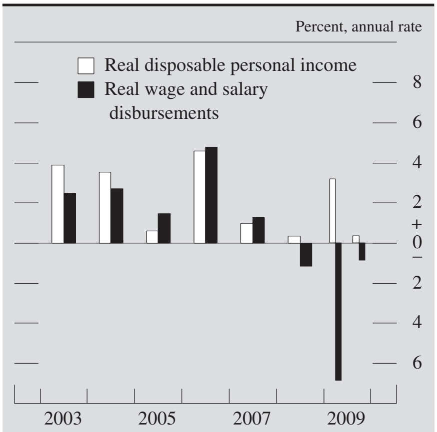
Real disposable personal income—after-tax income adjusted for inflation—increased about 1¾ percent last year, with the effects of the tax cuts and higher social benefit payments included in the 2009 fiscal stimulus package accounting for most of the increase.[7] Real labor income—that is, total wages, salaries, and employee benefits, adjusted for inflation—fell sharply in the first half of the 2009, and edged down a bit further in the second half, as the decline in total employee work hours more than offset an increase in real hourly compensation (figure 4).

After dropping during the preceding 2½ years, household net worth turned up in the second and third quarters of 2009 and likely rose further in the fourth quarter. Much of the recovery

6. Sales dropped back in January, but the decline occurred largely at Toyota, which was confronted by widely publicized problems.

7. The increases in benefit payments under the American Recovery and Reinvestment Act included an expansion of unemployment benefits, increases in food stamps and Pell grants, subsidies for health insurance coverage for the unemployed, and a one-time $250 payment to retirees and veterans.

4. Change in Real Income and in Real Wage and Salary Disbursements, 2003–09

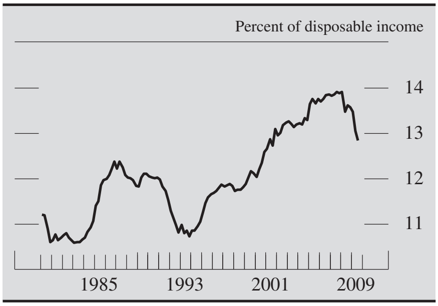


SOURCE: Department of Commerce, Bureau of Economic Analysis.

reflected a rebound in equity prices, although the modest gain, on net, in the value of owner-occupied real estate also contributed. With the rise in net worth, the ratio of household wealth to disposable income increased in the second half of the year to about its historical average.

Households began to deleverage around the third quarter of 2008, at the height of the financial crisis, and that process continued during the second half of 2009. The decline in nonmortgage consumer debt intensified during the latter part of last year. The contraction was most pronounced in revolving credit, which fell at about a 10 percent annual rate during the second half of 2009. Nonrevolving credit also decreased. Including the drop in mortgage debt, the Federal Reserve's flow of funds data indicate that total household debt declined in 2009 for the first time since the data series began in 1951. Reflecting these developments, debt service payments—the required principal and interest on existing mortgages

5. Household Debt Service, 1980–2009



NOTE: The data are quarterly and extend through 2009:Q3. Debt service payments consist of estimated required payments on outstanding mortgage and consumer debt.

SOURCE: Federal Reserve Board, "Household Debt Service and Financial Obligations Ratios," statistical release.

and consumer debt—fell as a share of disposable income. At the end of the third quarter, the ratio of debt service payments to disposable income had declined to its lowest level since 2001 (figure 5).

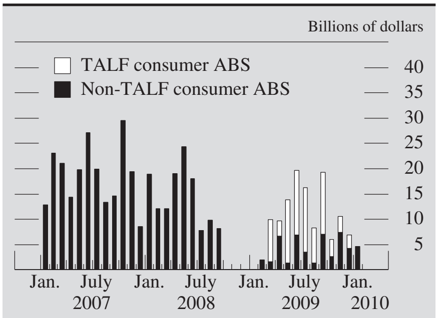
Results from the recent SLOOS suggest that the contraction in consumer credit has been the result of both weak demand and tight supply. A net fraction of about one-third of the bank loan officers that responded to the January SLOOS reported weaker demand for all types of consumer loans. The same survey also indicated that banks continued to tighten terms on credit card loans over the final three months of 2009 by reducing credit limits and raising interest rates charged, though smaller net fractions reported doing so than in previous surveys. After having been tightened significantly in the summer and fall of 2009, standards and terms on consumer loans other than credit card loans were little changed, on balance, in the January survey.

Changes in interest rates on consumer loans were mixed during the second half of 2009. Interest rates on new auto loans generally continued to trend lower, and spreads on these loans relative to comparable-maturity Treasury securities narrowed further. Interest rates on credit card loans, however, jumped near midyear and increased further toward year-end. According to the October SLOOS, some of the increases in credit card interest rates and the tightening of other lending terms reflected adjustments made by banks in anticipation of the imposition of new rules under the Credit Card Accountability Responsibility and Disclosure (Credit CARD) Act.[8]

Concerns about the ability of households to repay loans may also have contributed to the tightening of lending policies for consumer credit over the second half of 2009. Delinquency rates on auto loans at captive finance companies remained elevated, and credit card delinquency rates at commercial banks stayed high at around 6½ percent in the fourth quarter of 2009. In addition, the pace at which lenders were charging off these loans increased sharply in recent quarters. On a more positive note, respondents to the January SLOOS indicated that they expected the credit quality of their consumer loans, other than credit card loans, to stabilize during 2010.

Prior to the crisis, a large portion of consumer credit was funded through the ABS market. After having essentially ground to a halt at the end of 2008, consumer ABS markets recovered in 2009 with the important support of the TALF (figure 6). Much of the ABS issuance through the summer relied heavily on the TALF for financing. By the end of the year, the yields on such securities dropped markedly, and issuance of ABS without TALF support increased accordingly. (Indeed, the interest rates on TALF loans were chosen so that they would become unattractive as market conditions improved.) Issuance of ABS backed by auto loans in the second half of 2009 was roughly on par with issuance prior to the financial crisis, and only a small portion was purchased using loans from the TALF. A renewed ability to securitize auto loans may have contributed to the reduction in the interest rates on these loans. Similarly, ABS issuance backed by credit card receivables gained strength through most of the year, though it experienced a drop early in the fourth quarter because of uncertainty about how the Federal Deposit Insurance Corporation (FDIC) would treat securitized receivables should a sponsoring bank fail. Issuance picked up slightly after the FDIC provided a temporary extension of safe-harbor rules for its handling of

6. Gross Issuance of Selected Asset-Backed Securities, 2007–10



Note: Consumer ABS (asset-backed securities) are securities backed by credit card loans, nonrevolving consumer loans, and auto loans. Data for consumer ABS show gross issuance facilitated by the Term Asset-Backed Securities Loan Facility (TALF) and such issuance outside the TALF.

Source: Bloomberg and the Federal Reserve Bank of New York.

8. The Credit CARD Act includes some provisions that place restrictions on issuers' ability to impose certain fees and to engage in risk-based pricing. Some provisions took effect in August 2009, and others did so in February 2010.

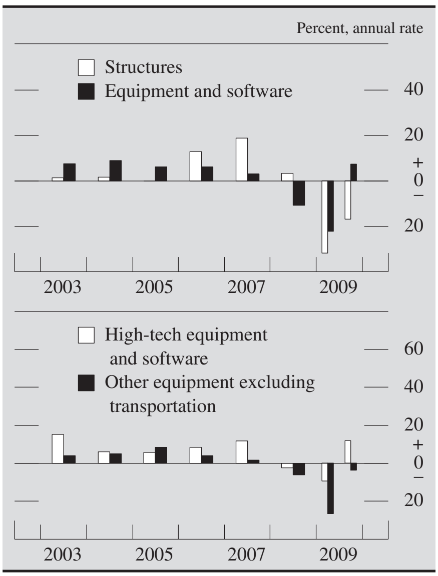
securitized assets in a receivership. By contrast, issuance of ABS backed by private student loans remained almost entirely dependent on financing from the TALF.

The Business Sector

Fixed Investment

After falling throughout 2008 and the first half of 2009, business spending on equipment and software (E&S) began to expand in the second half of last year, as sales prospects picked up, corporate profits increased, and financial conditions for many businesses (especially those with direct access to capital markets) improved (figure 7). Business outlays on transportation equipment rose sharply in the second half as firms rebuilt their fleets of light motor vehicles and accelerated their purchases of large trucks in advance of new environmental regulations on diesel engines. Real spending on information technology capital—computers, software, and communications equipment—also accelerated toward the end of 2009, likely boosted by the desire to replace older, less-efficient equipment. Investment in equipment other than information processing and transportation, which accounts for nearly one-half of E&S outlays, continued to fall during the second half of 2009, but much more slowly than earlier in the year. More recently, orders of nondefense capital goods other than transportation items posted a second strong monthly increase in December, and recent surveys of business conditions have been more upbeat than in several years.

7. Change in Real Business Fixed Investment, 2003–09



NOTE: High-tech equipment consists of computers and peripheral equipment and communications equipment.

SOURCE: Department of Commerce, Bureau of Economic Analysis.

In contrast to the upturn in equipment investment, real spending on nonresidential structures continued to decline steeply throughout 2009. Real outlays for construction of structures other than those used for drilling and mining fell at an annual rate of 25 percent in the second half of 2009, likely reflecting the drag from rising vacancy rates and plunging property prices for commercial and office buildings, as well as difficult financing conditions for new projects. Following a steep drop in the first half of the year, real spending on drilling and mining structures increased sharply in the second half, likely in response to the rebound in oil prices.

Inventory Investment

After running off inventories aggressively during the first three quarters of 2009, firms moved to stem the pace of liquidation in the fourth quarter.

Automakers added to their dealers' stocks after cutbacks in production earlier in the year had reduced days' supply of domestic light vehicles to below their preferred levels. Outside of motor vehicles, firms continued to draw down inventories in the fourth quarter, but at a much slower pace than earlier in the year. Indeed, purchasing managers in the manufacturing sector report that their customers' inventories are relatively lean, a development that could lead to some restocking in the coming months.

Corporate Profits and Business Finance

Overall, operating earnings per share for S&P 500 firms rebounded over the course of 2009. Still, earnings were well below the levels experienced prior to the financial market turmoil and the accompanying recession. Within the S&P 500, earnings for financial firms fluctuated around low levels, while earnings for nonfinancial firms rebounded sharply as the economic recovery began to take hold. Data from firms that have reported for the fourth quarter suggest that earnings for nonfinancial firms continued to recover.

The credit quality of nonfinancial corporations improved somewhat over the second part of last year, although signs of stress persisted. Business leverage, as measured by the ratio of debt to assets, fell in the third quarter. Credit rating downgrades outpaced upgrades early in 2009, but the pace of downgrades moderated substantially in the second half of the year, and by the fourth quarter upgrades were outpacing downgrades. In addition, the corporate bond default rate dropped into the range that had prevailed before the financial crisis began in August 2007.

Delinquency rates on loans to nonfinancial businesses, however, rose throughout the year. For commercial and industrial (C&I) loans, delinquencies in the fourth quarter reached 4.5 percent. In response to a special question on the January 2010 SLOOS, a large net fraction of banks reported that in the fourth quarter, the credit quality of their existing C&I loans to small firms was worse than the quality of their loans to larger firms. While survey respondents generally expected the credit quality of their C&I loan portfolios to improve during 2010, banks' outlook for C&I loans to larger firms was more optimistic than it was for such loans to smaller firms. Reflecting deterioration in commercial property markets, delinquency rates on commercial real estate (CRE) loans both in securitized pools and on banks' books moved up sharply in the second half of 2009. Delinquency rates on construction and land development loans climbed to especially high levels. In October 2009, the Federal Reserve joined with other banking regulators to provide guidelines to banks in their efforts to work constructively with troubled CRE borrowers.[9]

---

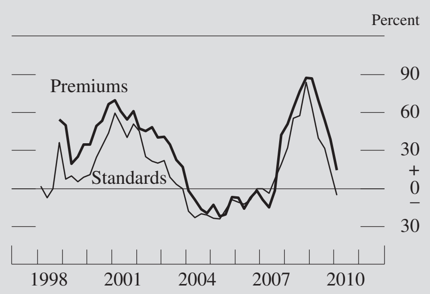
9. This statement updated and replaced existing supervisory guidance to assist examiners in evaluating institutions' efforts to renew or restructure loans to creditworthy CRE borrowers. The statement was intended to promote supervisory consistency, enhance the transparency of CRE workout transactions (that is, transactions intended to renew and restructure the loans), and ensure that supervisory policies and actions do not inadvertently curtail the availability of credit to sound borrowers. For more information, see Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Office of Thrift Supervision, and Federal Financial Institutions Examination Council State Liaison Committee (2009), "Policy Statement on Prudent Commercial Real Estate Loan Workouts," attachment to

The debt of domestic nonfinancial businesses contracted slightly during the second half of 2009, and the composition of borrowing continued to shift toward longer-term debt. Net issuance of corporate bonds remained strong as businesses took advantage of favorable market conditions to issue longer-term debt; at the same time, bank loans to businesses—both C&I and CRE loans—contracted, as did commercial paper.

The decline in bank lending to businesses was due partly to the weakness in loan demand. Many banks experiencing steep declines in C&I loans reported that existing loans were paid down across a wide swath of industries. Respondents to the January 2010 SLOOS indicated that weak demand for C&I loans during the second half of 2009 reflected their customers' reduced need to use these loans to finance investment in plant and equipment as well as to finance accounts receivable, inventories, and mergers and acquisitions. In addition, demand was reportedly low for CRE loans amid weak fundamentals in the sector.

The weakness in bank lending to businesses in 2009 was also a consequence of a tightening in lending standards. Responses to the SLOOS indicated that lending standards for C&I loans were tightened significantly in the summer and fall of 2009 and that they remained about unchanged in the final months of the year (figure 8). In addition, many banks continued to tighten some terms throughout the year—for example, by increasing the interest rate premiums charged on riskier loans. Considerable net fractions

8. Net Percentage of Domestic Banks Tightening Standards and Increasing Premiums Charged on Riskier Loans to Large and Medium-Sized Borrowers, 1998–2010



NOTE: The data are drawn from a survey generally conducted four times per year; the last observation is from the January 2010 survey, which covers 2009:Q4. Net percentage is the percentage of banks reporting a tightening of standards or an increase in premiums less the percentage reporting an easing or a decrease. The definition for firm size suggested for, and generally used by, survey respondents is that large and medium-sized firms have annual sales of $50 million or more.

SOURCE: Federal Reserve Board, Senior Loan Officer Opinion Survey on Bank Lending Practices.

of banks also continued to report tightening lending standards on CRE loans.

Small businesses have been particularly affected by tight bank lending standards because of their lack of direct access to capital markets. In surveys conducted by the National Federation of Independent Business (NFIB), the net fraction of small businesses reporting that credit had become more difficult to obtain over the preceding three months remained at extremely elevated levels during the second half of 2009. Moreover, considerable net fractions of NFIB survey respondents expected lending conditions to tighten further in the near term. However, when asked about the most important problem they faced, small businesses most frequently cited poor sales, while only a small fraction cited credit availability. Recognizing that small businesses play a crucial role in the economy and that some

Supervision and Regulation Letter SR 09-7 (October 30), www.federalreserve.gov/boarddocs/srletters/2009/sr0907a1.pdf.

are experiencing difficulty in obtaining or renewing credit, the federal financial regulatory agencies and the Conference of State Bank Supervisors issued a statement on February 5, 2010, regarding lending to these businesses.[10] The statement emphasized that financial institutions that engage in prudent small business lending will not be subject to supervisory criticism for small business loans made on that basis. Further, the statement emphasized that regulators are working with the industry and supervisory staff to ensure that supervisory policies and actions do not inadvertently curtail the availability of credit to financially sound small business borrowers.

In the equity market, both seasoned and initial offerings by nonfinancial firms were solid in the second half of 2009. After nearly ceasing earlier in the year, cash-financed mergers picked up toward year-end, mostly as the result of a few large deals. Share repurchases continued to be light.

New issuance in the commercial mortgage-backed securities (CMBS) market—which had ceased in the third quarter of 2008, thus eliminating an important source of financing for many lenders—resumed in November 2009 with a securitization supported by the Federal Reserve's TALF program. A handful of subsequent small securitizations, with more-conservative underwriting and simpler structures than had prevailed during the credit boom, were brought to market and successfully completed without support from the TALF. Nevertheless, issuance of CMBS remains very light, and material increases in issuance appeared unlikely in the near term. Trading in existing CMBS picked up during the second half of 2009, and yield spreads relative to Treasury securities narrowed, although they remain very high by historical standards. Some of the improvement likely reflected support provided by the Federal Reserve through the part of the TALF program that provides loans for the purchase of "legacy" CMBS.

Issuance of leveraged loans, which often involves loan extensions by nonbank financial institutions, also remained weak throughout 2009 although market conditions reportedly improved. Prior to the crisis, this segment of the syndicated loan market provided considerable financing to lower-rated nonfinancial firms. However, issuance of leveraged loans fell to low levels when investors moved away from structured finance products such as collateralized loan obligations, which had been substantial purchasers of such credits. The market began to show signs of recovery last year with secondary-market prices of loans moving higher, and, by late in the year, new loans had found increased investor interest amid some easing in loan terms.

The Government Sector

Federal Government

The deficit in the federal unified budget rose markedly in fiscal year 2009 and reached $1.4 trillion, about $1 trillion higher than in fiscal 2008. The effects of the weak economy on

10. For more information, see Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, National Credit Union Administration, and Conference of State Bank Supervisors (2010), "Interagency Statement on Meeting the Credit Needs of Creditworthy Small Business Borrowers," attachment to "Regulators Issue Statement on Lending to Creditworthy Small Businesses," joint press release, February 5, www.occ.treas.gov/ftp/release/2010-14.htm.

revenues and outlays, along with the budget costs associated with the fiscal stimulus legislation enacted last February (the American Recovery and Reinvestment Act (ARRA)), the Troubled Asset Relief Program, and the conservatorship of the mortgage-related GSEs, all contributed to the widening of the budget gap. The deficit is expected to remain sharply elevated in fiscal 2010. Although the budget costs of the financial stabilization programs are expected to be lower than in the last fiscal year, the spend-out from last year's fiscal stimulus package is expected to be higher, and tax revenues are anticipated to remain weak. The Congressional Budget Office projects that the deficit will be about $1.3 trillion this fiscal year, just a touch below last year's deficit, and that federal debt held by the public will reach 60 percent of nominal GDP, the highest level recorded since the early 1950s.

The steep drop in economic activity during 2008 and the first half of 2009 resulted in sharply lower tax receipts. After falling about 2 percent in fiscal 2008, federal receipts plunged 18 percent in fiscal 2009, and tax receipts over the first four months of the current fiscal year have continued to decline relative to the comparable year-earlier period. The decline in revenues in fiscal 2009 was particularly steep for corporate taxes, mostly as a result of the sharp contraction in corporate profits in 2008.[11] Individual income and payroll taxes also declined substantially, reflecting the effects of the weak labor market on nominal wage and salary income, a decline in capital gains realizations, and the revenue-reducing provisions of the 2009 fiscal stimulus legislation.

While the outlays associated with the TARP and the conservatorship of the GSEs contributed importantly to the rapid rise in federal spending in fiscal 2009, outlays excluding these extraordinary costs rose a relatively steep 10 percent.[12] Spending for Medicaid and income support programs jumped almost 25 percent in fiscal 2009 as a result of the deterioration in the labor market as well as policy decisions to expand funding for a number of such programs. This category of spending has continued to rise rapidly thus far in fiscal 2010, and most other categories of spending have increased fairly briskly as well.

As measured in the national income and product accounts (NIPA), real federal expenditures on consumption and gross investment—the part of federal spending that is a direct component of GDP—rose at a 4 percent pace in the second half of 2009. Nondefense outlays increased rapidly, in part reflecting the boost in spending from the 2009 fiscal stimulus legislation, while real defense outlays rose modestly.

Federal Borrowing

Federal debt expanded rapidly throughout 2009 and rose to more than 50 percent of nominal GDP by the end of 2009, up from around 35 percent earlier in the decade. To fund the increased borrowing needs, Treasury

11. Because final payments on 2008 liabilities were not due until April of 2009 and because of the difference between fiscal and calendar years, much of the contraction in 2008 corporate profits did not show through to tax revenues until fiscal 2009.

12. In the Monthly Treasury Statements, equity purchases and debt-related transactions under the TARP are recorded on a net present value basis, taking into account market risk, as are the Treasury's purchases of the GSE's MBS. However, equity purchases from the GSEs in conservatorship are recorded on a cash flow basis.

auctions grew to record sizes. However, demand for Treasury issues kept pace, and bid-to-cover ratios at these auctions were generally strong. Foreign demand was solid, and foreign custody holdings of Treasury securities at the Federal Reserve Bank of New York increased considerably over the year.

State and Local Government

Despite the substantial federal aid provided by the ARRA, the fiscal situations of state and local governments remain challenging. At the state level, revenues from income, business, and sales taxes continued to fall in the second half of last year, and many states are currently in the process of addressing shortfalls in their fiscal 2010 budgets. At the local level, revenues have held up fairly well, as receipts from property taxes, on which these jurisdictions rely heavily, have continued to rise moderately, reflecting the typically slow response of property assessments to changes in home values. Nevertheless, the sharp fall in house prices over the past few years is likely to put some downward pressure on local revenues before long. Moreover, many state and local governments have experienced significant capital losses in their employee pension funds, and they will need to set aside resources in coming years to rebuild pension assets.

These budget pressures showed through to state and local spending. As measured in the NIPA, real consumption expenditures of state and local governments declined over the second half of 2009.[13] In particular, these jurisdictions began to reduce employment in mid-2009, and those cuts continued in January. In contrast, investment spending by state and local governments rose moderately during the second half of 2009. The rise in investment spending was supported by infrastructure grants provided by the federal government as part of the ARRA, as well as by a recovery of activity in municipal bond markets that increased the availability and lowered the cost of financing. Also, because capital budgets are typically not encompassed within balanced budget requirements, states were under less pressure to restrain their investment spending.

State and Local Government Borrowing

Borrowing by state and local governments picked up a bit in the second half of the year from its already solid pace in the first half. Gross issuance of long-term bonds, primarily to finance new capital projects, was strong. Issuance was supported by the Build America Bonds program, which was authorized under the ARRA.[14] Short-term issuance was more moderate and generally consistent with typical seasonal patterns. Market participants reported that the market for variable-rate demand obligations, which became severely strained during the financial crisis, had largely recovered.[15]

13. Consumption expenditures by state and local governments include all outlays other than those associated with investment projects.

14. The Build America Bonds program allows state and local governments to issue taxable bonds for capital projects and receive a subsidy payment from the Treasury for 35 percent of interest costs.

15. Variable-rate demand obligations (VRDOs) are taxable or tax-exempt bonds that combine long maturities with floating short-term interest rates that are reset on a weekly, monthly, or other periodic basis. VRDOs also have a contractual liquidity backstop, typically provided by a commercial or investment bank, that ensures that

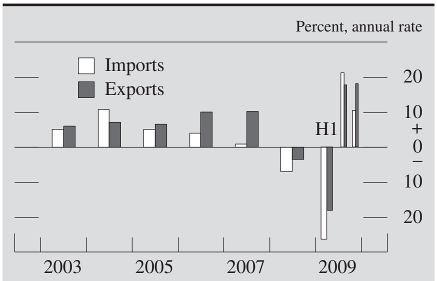
Interest rates on long-term municipal bonds declined during the year, but the ratio of their yields to those on comparable-maturity Treasury securities remained somewhat elevated by historical standards. Credit ratings of state and local governments deteriorated over 2009 as a consequence of budgetary problems faced by many of these governments.

The External Sector

Both exports and imports rebounded in the second half of 2009 from precipitous falls earlier in the year (figure 9). As foreign economic activity began to improve, real exports rose at an annual rate of nearly 20 percent in the second half of the year. Real imports increased at about the same pace, supported by the recovery under way in U.S. demand. The pickup in trade flows was widespread across major types of products and U.S. trading partners but was particularly pronounced for both exports and imports of capital goods. Exports and imports of automotive products also picked up sharply in the second half of last year, reflecting the rise in motor vehicle production in North America, which depends importantly on flows of parts and finished vehicles between the United States, Canada, and Mexico. Despite the bounceback, trade flows only partially retraced the unusually steep declines registered in late 2008 and early 2009. This pattern was also true for global trade flows, as discussed in the box "Developments in Global Trade." The strength of the recovery in global trade so far, however, differs substantially across countries and regions.

bondholders are able to redeem their investment at par plus accrued interest even if the securities cannot be successfully remarketed to other investors.

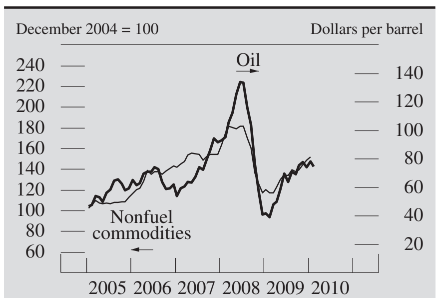
9. Change in Real Imports and Exports of Goods and Services, 2003–09



SOURCE: Department of Commerce, Bureau of Economic Analysis.

Oil and nonfuel commodity prices increased substantially over the year (figure 10). After plunging from a daily high of about $145 per barrel in mid-2008 to a low of less than $40 per barrel early in 2009, the spot price of West Texas Intermediate crude oil rose rapidly to reach about $70 per barrel by the middle of 2009. The price of oil rose further over the second half of the year to reach about $80 per barrel in November and has fluctuated between $70 and $80 per barrel through

10. Prices of Oil and Nonfuel Commodities, 2005–10



NOTE: The data are monthly. The oil price is the spot price of West Texas Intermediate crude oil, and the last observation is the average for February 1–17, 2010. The price of nonfuel commodities is an index of 45 primary-commodity prices and extends through January 2010.

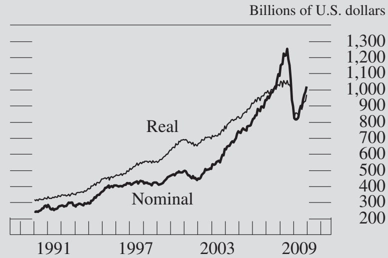
SOURCE: For oil, the Commodity Research Bureau; for nonfuel commodities, International Monetary Fund.

Developments in Global Trade

The downturn in global activity was accompanied by a dramatic collapse in global trade. Measured in U.S. dollars, global exports fell about 35 percent between July 2008 and February 2009.[1] About one-third of the decline was a result of falling prices, notably for oil and other commodities. The volume of global exports is estimated to have contracted about 20 percent between mid-2008 and early 2009, a larger and more abrupt decline than has been observed in previous cycles (figure A).

1. The total includes 44 countries. The emerging Asian economies consist of China, Hong Kong, India, Indonesia, Korea, Malaysia, the Philippines, Singapore, Taiwan, Thailand, and Vietnam; the Latin American economies consist of Argentina, Brazil, Chile, Colombia, Mexico, and Venezuela; the other emerging market economies consist of Hungary, Israel, Poland, Russia, South Africa, and Turkey; and the advanced economies consist of Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

A. Real and Nominal Global Exports, 1990–2009



Note: The data are monthly and extend through December 2009. Real global exports are staff estimates expressed in billions of 2007 U.S. dollars.

Source: The nominal data are the sum of U.S. dollar exports from individual country sources via databases maintained by Haver Analytics, CEIC, and the IMF Direction of Trade Statistics, in some cases seasonally adjusted by Federal Reserve staff. Forty-four countries are included. The real data are calculated using trade prices from country sources via Haver Analytics (in some cases interpolated from quarterly or annual data), which are converted to U.S. dollar prices using each country's dollar exchange rate and rebased to 2007.

mid-February 2010. The increase in the price of oil over the course of 2009 was driven in large measure by strengthening global activity, particularly in the emerging market economies. The ongoing effects of earlier restrictions in OPEC supply were another likely contributing factor. The prices of longer-term futures contracts (that is, those expiring in December 2018) for crude oil also moved up and, as of mid-February, were about $96 per barrel. The upward-sloping futures curve is consistent with a view by market participants that oil prices will continue to rise as global demand strengthens over the medium term.

Broad indexes of nonfuel commodity prices also rose from lows near the start of 2009. As with the rise in oil prices, a key driver of the increase in commodity prices has been resurgent demand from emerging market economies, especially China. Market participants expect some further increases in commodity prices as the economic recovery gains strength, albeit increases that are less pronounced than those recorded during last year's rebound.

The steep decline in commodity prices in late 2008 put considerable downward pressure on U.S. import prices for the first half of 2009. Overall for 2009, prices of imported goods fell 1 percent while prices for goods excluding oil fell 2½ percent. Recent upward moves in commodity prices suggest that some of this downward

Developments—continued

The fall in global exports was also more widespread across countries and regions than has typically been the case in past recessions. The severity of the decline in trade was a major factor in the spread of the economic downturn to the emerging market economies in Asia and Latin America, which were generally less directly exposed to the financial crisis than were the advanced economies. Early on, financial and economic indicators in the emerging market economies appeared to be relatively resilient, raising the possibility that those economies had "decoupled" from developments in the advanced economies. However, the trade channel proved quite potent, and most of the emerging market economies experienced deep recessions. A major exception was China, which provided considerable fiscal stimulus to its own economy.

The primary explanation for the deep and abrupt collapse in global trade seems to be that the contraction in global demand was much more severe than in the past. Constraints on the supply of trade finance related to the general credit crunch may have played a role at the beginning, but the fall in demand soon became the more important factor. The sensitivity of trade to the decline in gross domestic product also appears to have been stronger in this cycle than in past cycles, although there is no real agreement on why this might be the case. Greater integration of production across countries and an increase in exports of products for which there are shorter lags between changes in demand and changes in exports—such as electronics—may also have added to the speed and synchronicity of the collapse.

Exports appear to have stopped declining in most economies in the first half of 2009, but so far the strength of the recovery in trade has differed across countries. In particular, exports of the emerging Asian economies are much closer to their previous peaks than are exports of the advanced economies, as the strength of the Chinese economy has so far been a key factor driving exports of the other emerging Asian economies.

pressure on import prices will be reversed in 2010.

The U.S. trade deficit narrowed considerably in the first half of 2009. Nominal imports fell more than nominal exports early in the year, partly reflecting a substantial decline in the value of oil imports. The trade deficit widened moderately over the remainder of the year, however, as both imports and exports picked up in subsequent quarters and oil prices moved higher. In the fourth quarter of 2009, the trade deficit was $440 billion (annual rate), or about 3 percent of nominal GDP, compared with a deficit of 4 percent of nominal GDP a year earlier.

National Saving

Total U.S. net national saving—that is, the saving of households, businesses, and governments, excluding depreciation charges—remained extremely low by historical standards in 2009, averaging about negative 2½ percent of nominal GDP over the first three quarters of the year. After having reached nearly 4 percent of nominal GDP in early 2006, net national saving dropped over the subsequent three years as the federal budget deficit widened substantially and the fiscal positions of state and local governments deteriorated. In contrast, private saving rose considerably, on balance, over this period. National saving will likely remain relatively low this year in light of the continuing high federal budget deficit. If not raised over the longer run, persistent low levels of national saving will likely be associated with both low rates of capital formation and heavy borrowing from abroad, limiting the rise in the standard of living of U.S. residents over time.

The Labor Market

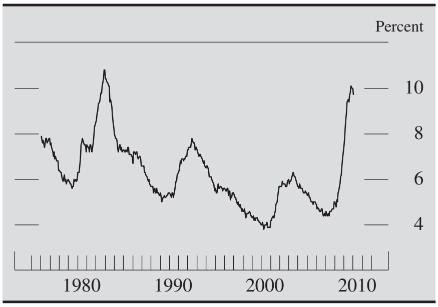
Employment and Unemployment

After falling sharply in the first half of 2009, employment continued to contract through the remainder of the year, but at a gradually moderating pace. Nonfarm private payroll employment fell 725,000 jobs per month, on average, from January to April of 2009; the pace of job loss slowed to about 300,000 per month from May to October, and to an average of 20,000 jobs per month from November to January (figure 11). The moderation in the pace of job losses was relatively widespread across sectors, although cutbacks in

11. Net Change in Private Payroll Employment, 2003–10

NOTE: The data are monthly and extend through January 2010.
SOURCE: Department of Labor, Bureau of Labor Statistics.

12. Civilian Unemployment Rate, 1976–2010



NOTE: The data are monthly and extend through January 2010.
SOURCE: Department of Labor, Bureau of Labor Statistics.

employment in the construction industry continued to be sizable through January.

After rising rapidly for more than a year, the unemployment rate stabilized at 10 percent in the fourth quarter of 2009 (figure 12). In January, the jobless rate dropped to 9.7 percent, though it remained 4.7 percentage points higher than its level two years ago.

The slowing in net job losses since mid-2009 primarily reflected a reduction in layoffs rather than an improvement in hiring. Both the number of new job losses and initial claims for unemployment insurance are down significantly from their highs in the spring of 2009, while most indicators of hiring conditions, such as the Bureau of Labor Statistics survey of job openings, remain weak. The average duration of an ongoing spell of unemployment continued to lengthen markedly in the second half of 2009, and joblessness became increasingly concentrated among the long-term unemployed. In January, 6.3 million individuals—more than 40 percent of the unemployed—had been out of work for at least six months. Furthermore, the labor force participation rate has declined steeply since last spring, a development likely related, at least in part, to the reactions of potential workers to the scarcity of employment opportunities.

However, in recent months, labor market reports have included some encouraging signs that labor demand may be firming. For example, employment in the temporary help industry, which frequently is one of the first to see an improvement in hiring, has been increasing since October. In addition, after steep declines in 2008 and the first quarter of 2009, the average workweek of production and nonsupervisory employees stabilized at roughly 33.1 hours per week through the remainder of the year, before ticking up to 33.2 hours in November and December and 33.3 hours in January. Another indicator of an improvement in work hours, the fraction of workers on part-time schedules for economic reasons, increased only slightly, on net, in the second half of the year after a sharp rise in the first half and then turned down noticeably in January.

Productivity and Labor Compensation

Labor productivity surged in 2009, reflecting, at least to some extent, the reluctance of firms to increase hiring even as demand expanded. According to the latest available published data, output per hour in the nonfarm business sector increased at an annual rate of 6¾ percent in the second half of 2009, after rising 3½ percent in the first half, and about 1 percent in 2008.

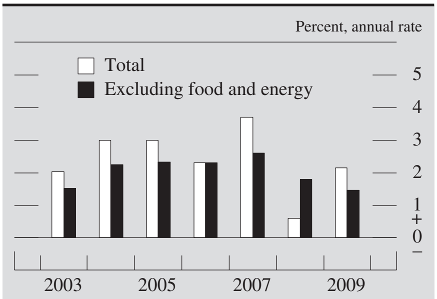
Despite large gains in productivity, increases in hourly worker compensation have remained subdued. The employment cost index for private industry workers, which measures both wages and the cost to employers of providing benefits, rose only 1¼ percent in nominal terms in 2009 after rising almost 2½ percent in 2008. Compensation per hour in the nonfarm business sector—a measure derived from the worker compensation data in the NIPA—showed less deceleration, rising 2.2 percent in nominal terms in 2009, only slightly slower than the 2.6 percent rise recorded for 2008. Real hourly compensation—that is, adjusted for the rise in consumer prices—increased only modestly. Reflecting the subdued increase in nominal hourly compensation, along with the outsized gain in labor productivity noted earlier, unit labor costs in the nonfarm business sector declined 2¾ percent in 2009.

Prices

Headline consumer price inflation picked up in 2009, as sharp increases in energy prices offset reductions in food prices and a deceleration in other prices. After rising ½ percent over the 12 months of 2008, overall prices for personal consumption expenditures rose about 2 percent in 2009. In contrast, the core PCE price index—which excludes the prices of energy items as well as those of food and beverages—increased a little less than 1½ percent in 2009, compared with a rise of roughly 1¾ percent in 2008 (figure 13). Data for PCE prices in January 2010 are not yet available, but information from the consumer price index and other sources suggests that inflation remained subdued.

Consumer energy prices rose sharply in 2009, reversing much of the steep decline recorded in 2008. The retail price of gasoline was up more than 60 percent for the year as a whole, driven higher by a resurgence in the cost of crude oil. Reflecting the burgeoning supplies from new domestic wells, consumer natural gas prices fell sharply over the first half of 2009, before in-

13. Change in the Chain-Type Price Index for Personal Consumption Expenditures, 2003–09



NOTE: Change is from December to December.
SOURCE: Department of Commerce, Bureau of Economic Analysis.

creasing again in the last few months of the year as the economic outlook improved. Electricity prices also fell during the early part of 2009 before retracing part of that decline later in the year. Overall, natural gas prices were down almost 20 percent in 2009, while electricity prices were about unchanged.

After posting sizable declines throughout much of 2009, food prices turned up modestly in the fourth quarter of last year. For the year as a whole, consumer food prices fell 1½ percent after rising 6¾ percent in 2008; these changes largely reflected the pass-through to retail of huge swings in spot prices of crops and livestock over the past two years.

Excluding food and energy, PCE price inflation slowed last year. Core PCE prices rose at an annual rate of 1¾ percent in the first half of 2009, similar to the pace in 2008, and then increased at an annual rate of only a little above 1 percent over the final six months of the year. This slowdown in core inflation was centered in a noticeable deceleration in the prices of nonenergy services. For those prices, firms' widespread cost-cutting efforts over the past year and the continued weakness in the housing market that has put downward pressure on housing costs have likely been important factors. The prices of many core consumer goods continued to rise only moderately in 2009; a notable exception was tobacco, for which tax-induced price hikes were substantial.

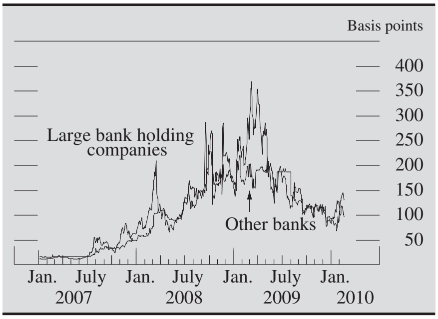
Survey-based measures of near-term inflation expectations, which were unusually low in the beginning of 2009, moved up, on average, over the remainder of the year. According to the Thomson Reuters/University of Michigan Surveys of Consumers, median expectations for year-ahead inflation stood at 2.8 percent in January, up from about 2 percent at the beginning of 2009. Historically, this short-term measure has been influenced fairly heavily by contemporaneous movements in energy prices. Longer-term inflation expectations, by contrast, have been relatively stable over the past year. For example, the Thomson Reuters/University of Michigan survey measure of median 5- to 10-year inflation expectations was 2.9 percent in January of this year, similar to the readings during most of 2009, and near the lower end of the narrow range that has prevailed over the past few years.

Financial Stability Developments

Evolution of the Financial Sector, Policy Actions, and Market Developments

The recovery in the financial sector that began in the first half of 2009 continued through the second half of the year and into 2010, as investor concerns about the health of large financial

14. Spreads on Credit Default Swaps for Selected U.S. Banks, 2007–10

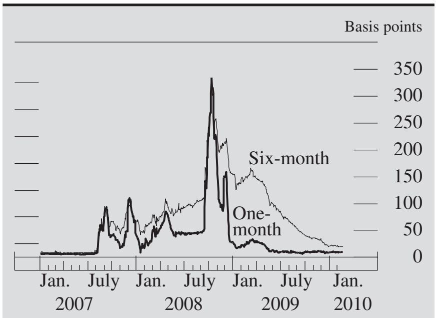


NOTE: The data are daily and extend through February 18, 2010. Median spreads for six bank holding companies and nine other banks.
SOURCE: Markit.

institutions subsided further. Credit default swap (CDS) spreads for banking institutions—which primarily reflect investors' assessments of and willingness to bear the risk that those institutions will default on their debt obligations—fell considerably from their peaks early in 2009, although they remain above pre-crisis levels (figure 14). Bank equity prices have increased significantly since spring 2009. Many of the largest bank holding companies were able to issue equity and repurchase preferred shares that had been issued to the Treasury under the TARP. Nonetheless, conditions in many banking markets remain very challenging, with delinquency and charge-off rates still elevated, especially on commercial and residential real estate loans. Investor concerns about insurance companies—which had come under pressure in early 2009 and a few of which had received capital injections from the Treasury—also diminished, as indicated by narrowing CDS spreads for those firms and increases in their equity prices. In December, the Treasury announced that it was amending the cap on its Preferred Stock Purchase Agreements with Fannie Mae and Freddie Mac to ensure that each firm would maintain positive net worth for the next three years, and it also announced that it was providing additional capital to GMAC under the TARP.

Consistent with diminishing concerns about the conditions of banking institutions, functioning in bank funding markets has improved steadily since the spring of last year. A measure of stress in these markets—the spread between the London interbank offered rate (Libor) and the rate on comparable-maturity overnight index swaps (OIS)—narrowed at all maturities; spreads at shorter maturities reached pre-crisis levels, while those at longer maturities remained somewhat elevated by historical standards (figure 15). Liquidity in term bank funding markets also improved at terms up to six months. Conditions improved in other money markets as well. Bid-asked spreads and haircuts applied to

15. Libor Minus Overnight Index Swap Rate, 2007–10



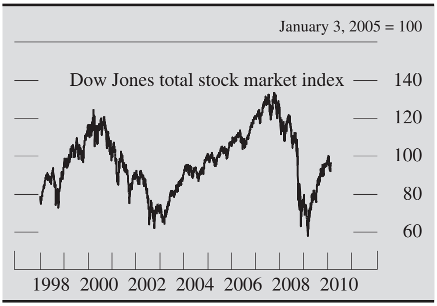
NOTE: The data are daily and extend through February 19, 2010. An overnight index swap (OIS) is an interest rate swap with the floating rate tied to an index of daily overnight rates, such as the effective federal funds rate. At maturity, two parties exchange, on the basis of the agreed notional amount, the difference between interest accrued at the fixed rate and interest accrued by averaging the floating, or index, rate. Libor is the London interbank offered rate.
SOURCE: For Libor, British Bankers' Association; for the OIS rate, Prebon.

collateral in repurchase agreement (repo) markets retraced some of the run-ups that had occurred during the financial market turmoil, though haircuts on most types of collateral continued to be sizable relative to pre-crisis levels. In the commercial paper market, spreads between rates on lower-quality A2/P2 paper and on asset-backed commercial paper over higher-quality AA nonfinancial paper fell to the low end of the range observed since the fall of 2007.

With improved conditions in financial markets, the Federal Reserve and other agencies removed some of the extraordinary support that had been provided during the crisis. Starting in the second half of 2009, the Federal Reserve began to normalize its lending to commercial banks. The amounts and maturity of credit auctioned through the Term Auction Facility (TAF) were reduced over time, and early in 2010 the Federal Reserve announced that the final TAF auction would be conducted in March 2010. Later, the Federal Reserve noted that the minimum bid rate for the final auction would be 50 basis points, ¼ percentage point higher than in recent auctions. The Federal Reserve also shortened the maximum maturity of loans provided under the primary credit program from 90 days to 28 days, effective on January 14, and announced a further reduction of the maximum maturity of those loans to overnight effective March 18. In addition, the rate charged on primary credit loans was increased from ½ percent to ¾ percent effective February 19. Amounts outstanding under many of the Federal Reserve's special liquidity facilities had dwindled to zero (or near zero) over the second half of 2009 as functioning of funding markets, both in the United States and abroad, continued to normalize. The Primary Dealer Credit Facility, the Term Securities Lending Facility, the Commercial Paper Funding Facility, the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, and the temporary liquidity swap lines with foreign central banks were all allowed to expire on February 1, 2010. Other government agencies also reduced their support to financial institutions. For instance, to buttress the liquidity of financial institutions, the FDIC had established in October 2008 a program to provide, in exchange for a fee, a guarantee on short- and medium-term debt issued by banking institutions. Financial institutions issued about $300 billion under this program, but use of the program declined after the summer of 2009 as financial institutions were able to successfully issue nonguaranteed debt. In light of these developments, the FDIC announced in late October 2009 that the guarantee program would be extended but with significant restrictions; no debt has been issued under the extended program.

Asset prices in longer-term capital markets have also staged a noticeable recovery since the spring of 2009, and risk premiums have narrowed noticeably as investors' appetite for risk appears to be recovering. In the corporate bond market, risk spreads on both investment- and speculative-grade bonds—the difference between the yields on these securities and those on comparable-maturity Treasury securities—dropped, and by the end of last year those spreads were within ranges observed during the recoveries from previous recessions. During the second half of 2009, the decline in risk spreads was accompanied by considerable inflows into mutual funds that invest in corporate bonds. In the leveraged loan market, the average bid price climbed back toward par, and bid-asked spreads

16. Stock Price Index, 1998–2010



NOTE: The data are daily and extend through February 18, 2010.
SOURCE: Dow Jones Indexes.

narrowed noticeably as trading conditions reportedly improved. Equity markets rebounded significantly over the past few quarters, leaving broad equity market indexes about 65 percent above the low point reached in March 2009 (figure 16).

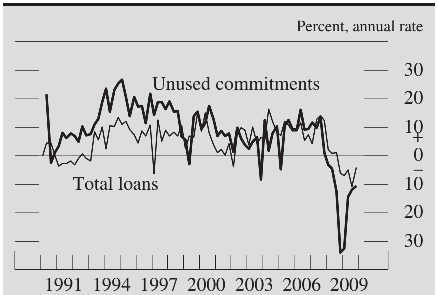
Overall, the rebound in asset prices likely reflected corporate earnings that were generally above market expectations, improved measures of corporate credit quality, and brighter economic prospects. Apparently, investors also became somewhat less concerned about the downside risks to the economic outlook, as suggested by declines in measures of uncertainty and risk premiums. Implied volatility on the S&P 500, as calculated from option prices, held at moderate levels during the second half of 2009 and was well off the peak reached in November 2008. Moreover, a measure of the premium that investors require for holding equity shares—the difference between the ratio of 12-month forward expected earnings to equity prices for S&P 500 firms and the long-term real Treasury yield—narrowed in 2009, though it remains elevated by historical standards.

Banking Institutions

The profitability of the commercial banking sector, as measured by the return on equity, continued to be quite low during the second half of 2009. Elevated loan loss provisioning continued to be the largest factor restraining earnings; however, provisioning decreased significantly in the second half of the year, suggesting that banks believe that credit losses may be stabilizing. While some banks saw earnings boosted earlier last year by gains in trading and investment banking activities, revenue from these sources is reported to have dropped back in the fourth quarter. Although delinquency and charge-off rates for residential mortgages and commercial real estate loans continued to climb in the second half of 2009, for most other types of loans these metrics declined or showed signs of leveling out.

During the year, bank holding companies issued substantial amounts of common equity. Significant issuance occurred in the wake of the release of the Supervisory Capital Assessment Program (SCAP) results, which indicated that some firms needed to augment or improve the quality of their capital in order to assure that, even under a macroeconomic scenario that was more adverse than expected, they would emerge from the subsequent two-year period still capable of meeting the needs of creditworthy borrowers. The 19 SCAP firms issued about $110 billion in new common equity; combined with conversions of preferred stock, asset sales, and other capital actions, these steps have added more than $200 billion to common equity since the beginning of 2009. Equity offerings were also undertaken by other financial firms, and some used the

17. Change in Total Bank Loans and Unused Bank Loan Commitments to Businesses and Households, 1990–2009



NOTE: The data, which are not seasonally adjusted, are quarterly and extend through 2009:Q4. Total loans are adjusted to remove the effects of large thrifts converting to commercial banks or merging with a commercial bank.

SOURCE: Federal Financial Institutions Examination Council, Consolidated Reports of Condition and Income (Call Report).

proceeds to repay funds received as part of the Capital Purchase Program.

Against a backdrop of weak loan demand and tight credit policies throughout 2009, total loans on banks' books contracted even more sharply in the last two quarters taken together than in the first half of the year (figure 17). Outstanding unused loan commitments to both businesses and households also declined, albeit at a slower pace than in early 2009. The decline in loans was partially offset by an increase in holdings of securities, particularly Treasury securities and agency MBS, and a further rise in balances at the Federal Reserve. On balance, total industry assets declined. The decline in assets combined with an increase in capital to push regulatory capital ratios considerably higher.

The Financial Accounting Standards Board published Statements of Financial Accounting Standards Nos. 166 and 167 (FAS 166 and 167) in June 2009. The new standards modified the basis for determining whether a firm must consolidate securitized assets (as well as the associated liabilities and equity) onto its balance sheet; most banking organizations must implement the standards in the first quarter of 2010. Industry analysts estimate that banking organizations will consolidate approximately $600 billion of additional assets as a result of implementing FAS 166 and 167. A small number of institutions with large securitization programs will be most affected. While the regulatory capital ratios of the affected banking organizations may decrease after implementation of FAS 166 and 167, the ratios of organizations most affected by the accounting change are expected to remain substantially in excess of regulatory minimums. The federal banking agencies recently published a related risk-based capital rule that includes an optional one-year phase-in of certain risk-based capital impacts resulting from implementation of FAS 166 and 167.[16]

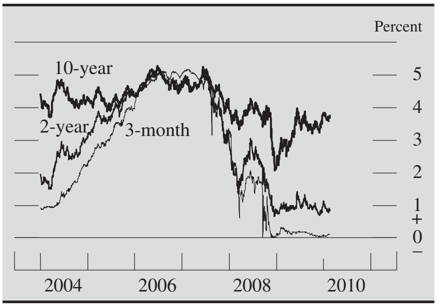
16. For more information and the text of the final rule, see Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of Thrift Supervision (2010), "Agencies Issue Final Rule for Regulatory Capital Standards Related to Statements of Financial Accounting Standards Nos. 166 and 167," press release, January 21, www.federalreserve.gov/newsevents/press/bcreg/20100121a.htm. The final rule was also published in the *Federal Register;* see Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Office of Thrift Supervision (2010), "Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues," final rule, *Federal Register,* vol. 75 (January 28), pp. 4636–54.

Monetary Policy Expectations and Treasury Rates

In July 2009, market participants had expected the target federal funds rate to be close to the current target range of 0 to ¼ percent in early 2010, but they had also anticipated that the removal of policy accommodation would be imminent. Over the second half of 2009, however, investors marked down their expectations for the path of the federal funds rate. Quotes on futures contracts imply that, as of mid-February 2010, market participants anticipate that policy will be tightened beginning in the third quarter of 2010, and that the tightening will proceed at a pace slower than was expected last summer. However, uncertainty about the size of term premiums and potential distortions created by the zero lower bound for the federal funds rate continue to make it difficult to obtain a definitive reading on the policy expectations of market participants from futures prices. The downward revision in policy expectations since July likely has reflected incoming economic data pointing to a somewhat weaker trajectory for employment and a lower path for inflation than had been anticipated. Another contributing factor likely was Federal Reserve communications, including the reiteration in the statement released after each meeting of the Federal Open Market Committee that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period.

Yields on shorter-maturity Treasury securities have edged lower since last summer, consistent with the downward shift in the expected policy path (figure 18). However, yields on longer-maturity nominal Treasury securities have increased slightly, on net, likely in response to generally positive news

18. Interest Rates on Selected Treasury Securities, 2004–10



Note: The data are daily and extend through February 18, 2010.
Source: Department of the Treasury.

about the economy and declines in the weight investors had placed on extremely adverse economic outcomes. The gradual tapering and the completion of the Federal Reserve's large-scale asset purchases of Treasury securities in October 2009 appeared to put little upward pressure on Treasury yields.

Yields on Treasury inflation-protected securities (TIPS) declined somewhat in the second half of 2009 and into 2010. The result was an increase in inflation compensation—the difference between comparable-maturity nominal yields and TIPS yields. The increase was concentrated at shorter-maturities and was partly a response to rising prices of oil and other commodities. Inflation compensation at more distant horizons was somewhat volatile and was little changed on net. Inferences about investors' inflation expectations have been more difficult to make since the second half of 2008 because special factors, such as safe-haven demands and an increased preference of investors for liquid assets, appear to have significantly affected the relative demand for nominal and inflation-indexed securities. These special factors began to abate in the first half of 2009 and receded further in the second half of the year, and the resulting changes in nominal and inflation-adjusted yields may have accounted for part of the recent increase in inflation compensation. On net, survey measures of longer-run inflation expectations have remained stable.

Monetary Aggregates and the Federal Reserve's Balance Sheet

After a brisk increase in the first half of the year, the M2 monetary aggregate expanded slowly in the second half of 2009 and in early 2010.[17] The rise in the latter part of the year was driven largely by increases in liquid deposits, as interest rates on savings deposits were reduced more slowly than rates on other types of deposits, and households and firms maintained some preference for safe and liquid assets. Outflows from small time deposits and retail money market mutual funds intensified during the second half of 2009, likely because of ongoing declines in the interest rates offered on these products. The currency component of the money stock expanded modestly in the second half of the year. The monetary base—essentially the sum of currency in circulation and the reserve balances of depository institutions held at the Federal Reserve—expanded rapidly for much of the second half of 2009, as the increase in reserve balances resulting from the large-scale asset purchases more than offset the decline caused by reduced usage of the Federal Reserve's credit programs. However, the monetary base increased more slowly toward the end of 2009 and in early 2010 as these purchases were tapered and as use of Federal Reserve liquidity facilities declined.

The nontraditional monetary policy actions taken by the Federal Reserve since the onset of the financial crisis expanded the size of the Federal Reserve's balance sheet considerably during 2008, and it remained very large throughout 2009 and into 2010 (table 1). Total Federal Reserve assets on February 17, 2010, stood at about $2.3 trillion. The compositional shifts that had been under way in the first half of 2009 continued during the remainder of the year. Lending to depository institutions as well as credit extended under special liquidity facilities and the temporary liquidity swaps with foreign central banks contracted sharply. By contrast, the large-scale asset purchases conducted by the Federal Reserve boosted securities held outright. Holdings of agency MBS surpassed $1 trillion early this year, up from about $525 billion in mid-July 2009. For other types of securities, the increases were more modest, with holdings of agency debt expanding from about $100 billion in July 2009 to $165 billion in February and holdings of Trea-

17. M2 consists of (1) currency outside the U.S. Treasury, Federal Reserve Banks, and the vaults of depository institutions; (2) traveler's checks of nonbank issuers; (3) demand deposits at commercial banks (excluding those amounts held by depository institutions, the U.S. government, and foreign banks and official institutions) less cash items in the process of collection and Federal Reserve float; (4) other checkable deposits (negotiable order of withdrawal, or NOW, accounts and automatic transfer service accounts at depository institutions; credit union share draft accounts; and demand deposits at thrift institutions); (5) savings deposits (including money market deposit accounts); (6) small-denomination time deposits (time deposits issued in amounts of less than $100,000) less individual retirement account (IRA) and Keogh balances at depository institutions; and (7) balances in retail money market mutual funds less IRA and Keogh balances at money market mutual funds.

1. Selected Components of the Federal Reserve Balance Sheet, 2008–10

Millions of dollars

Balance sheet item	Dec. 31, 2008	July 15, 2009	Feb. 17, 2010
Total assets	**2,240,946**	**2,074,822**	**2,280,952**
Selected assets			
Credit extended to depository institutions and dealers			
Primary credit	93,769	34,743	14,156
Term auction credit	450,219	273,691	15,426
Central bank liquidity swaps	553,728	111,641	0
Primary Dealer Credit Facility and other broker-dealer credit	37,404	0	0
Credit extended to other market participants			
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility	23,765	5,469	0
Net portfolio holdings of Commercial Paper Funding Facility LLC	334,102	111,053	7,721
Net portfolio holdings of LLCs funded through the Money Market Investor Funding Facility	0	0	0
Term Asset-Backed Securities Loan Facility	. . .	30,121	47,182
Support of critical institutions			
Net portfolio holdings of Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC[1]	73,925	60,546	65,089
Credit extended to American International Group, Inc.	38,914	42,871	25,535
Preferred interests in AIA Aurora LLC and ALICO Holdings LLC	. . .	. . .	25,106
Securities held outright			
U.S. Treasury securities	475,921	684,030	776,571
Agency debt securities	19,708	101,701	165,587
Agency mortgage-backed securities (MBS)[2]	. . .	526,418	1,025,541
Memo			
Term Securities Lending Facility[3]	171,600	4,250	0
Total liabilities	**2,198,794**	**2,025,348**	**2,228,425**
Selected liabilities			
Federal Reserve notes in circulation	853,168	870,327	892,985
Reserve balances of depository institutions	860,000	808,824	1,205,165
U.S. Treasury, general account	106,123	65,234	49,702
U.S. Treasury, supplemental financing account	259,325	199,939	5,000
Total capital	**42,152**	**49,474**	**52,527**

Note: LLC is a limited liability company.

1. The Federal Reserve has extended credit to several LLCs in conjunction with efforts to support critical institutions. Maiden Lane LLC was formed to acquire certain assets of The Bear Stearns Companies, Inc. Maiden Lane II LLC was formed to purchase residential mortgage-backed securities from the U.S. securities lending reinvestment portfolio of subsidiaries of American International Group, Inc. (AIG). Maiden Lane III LLC was formed to purchase multisector collateralized debt obligations on which the Financial Products group of AIG has written credit default swap contracts.

2. Includes only MBS purchases that have already settled.

3. The Federal Reserve retains ownership of securities lent through the Term Securities Lending Facility.

. . . Not applicable.

Source: Federal Reserve Board.

sury securities rising from nearly $700 billion to approximately $775 billion over the same period. The revolving credit provided to American International Group, Inc. (AIG), declined near year-end, as the outstanding balance was reduced in exchange for preferred interests in AIA Aurora LLC and ALICO Holdings LLC, which are life insurance holding company subsidiaries of AIG. Loans related to the Maiden Lane facilities—which represent credit extended in conjunction with efforts to avoid disorderly failures of The Bear Stearns Companies, Inc., and AIG—stayed roughly steady. On the liability side of the Federal Reserve's balance sheet, reserve balances increased from slightly more than $800 billion in July to about $1.2 trillion as of February 17, 2010, while the Treasury's supplementary financing account fell to $5 billion; the decline in the supplementary financing account occurred late in 2009 as part of the Treasury's efforts to retain flexibility in debt management as federal debt approached the debt ceiling.

International Developments

International Financial Markets

Global financial markets recovered considerably in 2009 as the effectiveness of central bank and government actions in stabilizing the financial system became more apparent and as signs of economic recovery began to take hold. Stock markets in the advanced foreign economies registered gains of about 50 percent from their troughs in early March, although they remain below their levels at the start of the financial crisis in August 2007. Stock markets in the emerging market economies rebounded even more impressively over the year. Most Latin American and many emerging Asian stock markets are now close to their levels at the start of the crisis.

As global prospects improved, investors shifted away from the safe-haven investments in U.S. securities they had made at the height of the crisis. As a result, the dollar, which had appreciated sharply in late 2008, depreciated against most other currencies in the second and third quarters of 2009. The dollar depreciated particularly sharply against the currencies of major commodity-producing nations, such as Australia and Brazil, as rising commodity prices supported economic recovery in those countries. In the fourth quarter, the dollar stabilized and has since appreciated somewhat, on net, as investors began to focus more on economic news and prospects for the relative strength of the economic recoveries in the United States and elsewhere (figure 19). Chinese authorities held the renminbi steady against the dollar throughout the year. For 2009 as a whole, the dollar depreciated roughly 4½ percent on a trade-weighted basis against the major foreign currencies and 3½ percent against the currencies of the other important trading partners of the United States.

Sovereign bond yields in the advanced economies rose over most of 2009 as investors moved out of safe investments in government securities and became more willing to purchase riskier securities. Concerns about rising budget deficits in many countries and the associated borrowing needs also likely contributed to the increase in

19. U.S. Dollar Nominal Exchange Rate, Broad Index, 2005–10

NOTE: The data, which are in foreign currency units per dollar, are daily. The last observation for the series is February 18, 2010. The broad index is a weighted average of the foreign exchange values of the U.S. dollar against the currencies of a large group of the most important U.S. trading partners. The index weights, which change over time, are derived from U.S. export shares and from U.S. and foreign import shares.

SOURCE: Federal Reserve Board, Statistical Release H.10, "Foreign Exchange Rates."

yields. Late in the year, the announcement of a substantial upward revision to the budget deficit in Greece led to a sharp rise in spreads of Greece's sovereign debt over comparable yields on Germany's sovereign debt. These spreads remained elevated in early 2010 and also increased in other euro-area countries with sizable budget deficits, especially Portugal and Spain. Sovereign yields in most of the advanced economies, however, remained significantly lower than prior to the financial crisis, as contained inflation, expectations of only slow economic recovery, and easing of monetary policy by central banks have all worked to keep long-term nominal interest rates low.

Conditions in global money markets have continued to improve. One-month Libor-OIS spreads in euros and sterling are now less than 10 basis points, near their levels before the crisis. Dollar funding pressures abroad have also substantially abated, and foreign firms are more easily able to obtain dollar funding through private markets such as those for foreign exchange swaps. As a result, drawings on the Federal Reserve's temporary liquidity swap lines by foreign central banks declined in the second half of 2009 to only about $10 billion by the end of the year, and funding markets continued to function without disruption as these swap lines expired on February 1, 2010.

The Financial Account

The pattern of financial flows between the United States and the rest of the world in 2009 reflected the recovery under way in global markets. As the financial crisis eased, net bank lending abroad resumed, but the recovery in portfolio flows was mixed.

Total private financial flows reversed from the large net inflows that had characterized the second half of 2008 to large net outflows in the first half of 2009. This reversal primarily reflected changes in net bank lending. Banks located in the United States had sharply curtailed their lending abroad as the financial crisis intensified in the third and fourth quarters of 2008, and they renewed their net lending as functioning of interbank markets improved in the first half of 2009. During the second half of 2009, interbank market conditions continued to normalize, and net bank lending proceeded at a moderate pace. The increased availability of funding in private markets also led to reduced demand from foreign central banks for drawings on the liquidity swap lines with the Federal Reserve. Repayment of the drawings in the first half of 2009 generated sizable U.S. official inflows that offset the large private banking outflows.

Foreign official institutions continued purchasing U.S. Treasury securities at a strong pace throughout 2009, as they had during most of the crisis. Foreign exchange intervention by several countries to counteract upward pressure on their currencies gave a boost to these purchases. Countries conducting such intervention bought U.S. dollars in foreign currency markets and acquired U.S. assets, primarily Treasury securities, with the proceeds.

During the height of the crisis, private foreign investors had also purchased record amounts of U.S. Treasury securities, likely reflecting safe-haven demands. Starting in April 2009, as improvement in financial conditions became more apparent, private foreigners began to sell U.S. Treasury securities, but net sales in the second and third quarters were modest compared with the amounts acquired in previous quarters. The recovery in foreign demand for riskier U.S. securities was mixed. Foreign investment in U.S. equities picked up briskly after the first quarter of 2009, nearly reaching a pre-crisis pace. However, foreign investors continued small net sales of U.S. corporate and agency debt. Meanwhile, U.S. investment in foreign securities bounced back quickly and remained strong throughout 2009.

Advanced Foreign Economies

Economic activity in the advanced foreign economies continued to fall sharply in early 2009 but began to recover later in the year as financial conditions improved and world trade rebounded. The robust recovery in emerging Asia helped the Japanese economy to turn up in the second quarter, and other major foreign economies returned to positive economic growth in the second half. Nevertheless, performance has been mixed. Spurred by external demand and a reduction in the pace of inventory destocking, industrial production has risen in most countries but remains well below pre-crisis levels. Business confidence has shown considerable improvement, and survey measures of manufacturing activity have risen as well. Consumer confidence also has improved as financial markets have stabilized, but household finances remain stressed, with unemployment at high levels and wage gains subdued. Although government incentives helped motor vehicle purchases to bounce back from the slump in early 2009, other household spending has remained sluggish in most countries. Housing prices have recovered somewhat in the United Kingdom and more in Canada but have continued to decline in Japan and in some euro-area countries.

Twelve-month consumer price inflation moved lower through the summer, with headline inflation turning negative in all the major advanced foreign countries except the United Kingdom. However, higher energy prices in the second half of 2009 pushed inflation back into positive territory except in Japan. Core consumer price inflation, which excludes food and energy, has fluctuated less.

Foreign central banks cut policy rates aggressively during the first half of 2009 and left those rates at historically low levels through year-end. The European Central Bank (ECB) has held its main policy rate at 1 percent since May and has made significant amounts of long-term funding available at this rate, allowing overnight interest rates to fall to around 0.35 percent. The Bank of Canada has indicated that it expects to keep its target for the overnight rate at a record low 0.25 percent until at least mid-2010. In addition to their interest rate moves, foreign central banks pursued unconventional monetary easing. The Bank of England continued its purchases of British treasury securities, increasing its Asset Purchase Facility from £50 billion to £200 billion over the course of the year. Amid concerns about persistent deflation, the Bank of Japan announced a new ¥10 trillion three-month secured lending facility at an unscheduled meeting on December 1. The ECB has continued its planned purchases of up to €60 billion in covered bonds, but it has also taken some initial steps toward scaling back its enhanced credit support measures, as it sees reduced need for special programs to provide liquidity.

Emerging Market Economies

Recovery from the global financial crisis has been more pronounced in the emerging market economies than in the advanced foreign economies. In aggregate, emerging market economies continued to contract in the first quarter of 2009, but economic activity in many countries, particularly in emerging Asia, rebounded sharply in the second quarter and remained robust in the second half of the year. The upturn in economic activity was driven largely by domestic demand, which received strong boosts from monetary and fiscal stimulus. By the end of 2009, the level of real GDP in several emerging market economies had recovered to or was approaching pre-crisis peaks. With significant spare capacity as a result of the earlier steep contraction in activity in these economies, inflation remained generally subdued through the first half of last year but moved up in the fourth quarter as adverse weather conditions led to a sharp rise in food prices.

In China, the fiscal stimulus package enacted in November 2008, combined with a surge in bank lending, led to a sharp rise in investment and consumption. Strong domestic demand contributed to a rebound in imports, which helped support economic activity in the rest of Asia and in commodity-exporting countries. Chinese authorities halted the modest appreciation of their currency against the dollar in the middle of 2008, and the exchange rate between the renminbi and the dollar has been unchanged since then. In the second half of 2009, authorities acted to slow the increase in bank lending to a more sustainable pace after the level of outstanding loans rose in the first half of the year by nearly one-fourth of nominal GDP. With the economy booming and inflation picking up, the People's Bank of China (the central bank) increased the required reserve ratio for banks ½ percentage point in January 2010 and again in February, the country's first significant monetary policy tightening moves since the financial crisis. In China and elsewhere in Asia, asset prices have rebounded sharply after falling steeply in the second half of 2008.

In Latin America, the rebound in activity has lagged that in Asia. Economic activity in Mexico, which is more closely tied to U.S. production and was adversely affected by the outbreak of the H1N1 virus last spring, did not turn up until the third quarter of 2009, but it then grew rapidly. In Brazil, the recession was less severe than in Mexico, and economic growth has been fairly strong since the second quarter of last year, supported in part by government stimulus and rising commodity prices.

Russia and many countries in emerging Europe suffered severe output contractions in the first half of 2009 and, in some cases, further financial stresses. In particular, Latvia faced difficulties meeting the fiscal conditions of its international assistance package, which heightened concerns about the survival of the Latvian currency regime. However, economic and financial conditions in emerging Europe began to recover in the second half of the year.

Part 3
Monetary Policy: Recent Developments and Outlook

Monetary Policy over the Second Half of 2009 and Early 2010

In order to provide monetary stimulus to support a sustainable economic expansion, the Federal Open Market Committee (FOMC) maintained a target range for the federal funds rate of 0 to ¼ percent throughout 2009 and into early 2010. The Federal Reserve also continued its program of large-scale asset purchases, completing purchases of $300 billion in Treasury securities and making considerable progress toward completing its announced purchases of $1.25 trillion of agency mortgage-backed securities (MBS) and about $175 billion of agency debt.

However, with financial market conditions improving, the Federal Reserve took steps to begin winding down many of its special credit and liquidity programs in 2009. On June 25, the Federal Reserve announced that it was extending the authorizations of several of these programs from October 30, 2009, to February 1, 2010. However, the terms of some of these facilities were tightened somewhat, the amounts to be offered under the Term Auction Facility (TAF) were reduced, and the authorization for the Money Market Investor Funding Facility was not extended.[18] Over the summer, the Federal Reserve continued to trim the amounts offered through the TAF.

The information reviewed at the August 11–12 FOMC meeting suggested that overall economic activity was stabilizing after having contracted during 2008 and early 2009. Nonetheless, meeting participants generally saw the economy as likely to recover only slowly during the second half of 2009 and as still vulnerable to adverse shocks. Although housing activity apparently was beginning to turn up, the weak labor market continued to restrain household income, and earlier declines in net worth were still holding back spending. Developments in financial markets leading up to the meeting were broadly positive, and the cumulative improvement in market functioning since the spring was significant. However, the pickup in financial markets was seen as due, in part, to support from various government programs. Moreover, credit remained tight, with many banks reporting that they continued to tighten loan standards and terms. Overall prices for personal consumption expenditures (PCE) rose in June after changing little in each of the previous three months. Excluding food and energy, PCE prices moved up moderately in June.

Given the prospects for an initially modest economic recovery, substantial resource slack, and subdued inflation, the Committee agreed at its August meeting that it should maintain its target range for the federal funds rate at 0 to ¼ percent. FOMC participants expected only a gradual upturn in economic activity and subdued inflation and thought it most likely that the federal funds rate would need to be maintained at an exceptionally low level for an extended period. With the downside risks to the economic outlook now considerably reduced but the economic recovery likely to be subdued, the Committee also agreed that neither expansion nor contraction of its program of asset purchases was warranted at the time. The Committee did, however, decide to gradually slow the pace

18. In particular, the Federal Reserve began requiring money market mutual funds to have experienced redemptions exceeding a certain threshold before becoming eligible to borrow from the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility. The Federal Reserve also suspended auctions conducted under the Term Securities Lending Facility (TSLF) involving only Schedule 1 collateral and reduced the frequency of TSLF auctions involving Schedule 2 collateral. Schedule 1 collateral refers to securities eligible for the open market operations arranged by the Federal Reserve's Open Market Trading Desk—generally Treasury securities, agency debt, or agency MBS. Schedule 2 collateral includes all Schedule 1 collateral as well as investment-grade corporate, municipal, mortgage-backed, and asset-backed securities.

of the remainder of its purchases of $300 billion of Treasury securities and extend their completion to the end of October to help promote a smooth transition in financial markets. Policymakers noted that, with the programs for purchases of agency debt and MBS not due to expire until the end of the year, they did not need to make decisions at the meeting about any potential modifications to those programs.

By the time of the September 22–23 FOMC meeting, incoming data suggested that overall economic activity was beginning to pick up. Factory output, particularly motor vehicle production, rose in July and August. Consumer spending on motor vehicles during that period was boosted by government rebates and greater dealer incentives. Household spending outside of motor vehicles appeared to rise in August after having been roughly flat from May through July. Sales data for July indicated further increases in the demand for both new and existing single-family homes. Although employment continued to contract in August, the pace of job losses had slowed noticeably from earlier in the year. Developments in financial markets were again regarded as broadly positive; meeting participants saw the cumulative improvement in market functioning and pricing since the spring as substantial. Despite these positive factors, participants still viewed the economic recovery as likely to be quite restrained. Credit from banks remained difficult to obtain and costly for many borrowers; these conditions were expected to improve only gradually. Many regional and small banks were vulnerable to the deteriorating performance of commercial real estate loans. In light of recent experience, consumers were likely to be cautious in spending, and business contacts indicated that their firms would also be cautious in hiring and investing even as demand for their products picked up. Some of the recent gains in economic activity probably reflected support from government policies, and participants expressed considerable uncertainty about the likely strength of the upturn once those supports were withdrawn or their effects waned. Core consumer price inflation remained subdued, while overall consumer price inflation increased in August, boosted by a sharp upturn in energy prices.

Although the economic outlook had improved further and the risks to the forecast had become more balanced, the recovery in economic activity was likely to be protracted. With substantial resource slack likely to persist and longer-term inflation expectations stable, the Committee anticipated that inflation would remain subdued for some time. Under these circumstances, the Committee judged that the costs of the economic recovery turning out to be weaker than anticipated could be relatively high. Accordingly, the Committee agreed to maintain its target range for the federal funds rate at 0 to ¼ percent and to reiterate its view that economic conditions were likely to warrant an exceptionally low level of the federal funds rate for an extended period. With respect to the large-scale asset purchase programs, the Committee indicated its intention to purchase the full $1.25 trillion of agency MBS that it had previously established as the maximum for this program. With respect to agency debt, the Committee agreed to reiterate its intention to purchase up to $200 billion of these securities. To promote a smooth transition in markets as these programs concluded, the Committee decided to gradually slow the pace of both its agency MBS and agency debt purchases and to extend their completion through the end of the first quarter of 2010. To keep inflation expectations well anchored, policymakers agreed on the importance of the Federal Reserve continuing to communicate that it has the tools and willingness to begin withdrawing monetary policy accommodation at the appropriate time and pace to prevent any persistent increase in inflation.

On September 24, the Board of Governors announced a gradual reduction in amounts to be auctioned under the TAF through January and indicated that auctions of credit with maturities longer than 28 days would be phased out by the end of 2009. Usage of the TAF had been declining in recent months as financial market conditions had continued to improve. The Money Market Investor Funding Facility, which had been established in October 2008 to help arrest a run on money market mutual funds, expired as scheduled on October 30, 2009.

At the November 3–4 FOMC meeting, participants agreed that the incoming information suggested that economic activity was picking up as anticipated, with output continuing to expand in the fourth quarter. Business inventories were being brought into better alignment with sales, and the pace of inventory runoff was slowing. The gradual recovery in construction of single-family homes from its extremely low level earlier in the year appeared to be continuing. Consumer spending appeared to be rising even apart from the effects of fiscal incentives to purchase autos. Financial market developments over recent months were generally regarded as supportive of continued economic recovery. Further, the outlook for growth abroad had improved since earlier in the year, especially in Asia, auguring well for U.S. exports. Meanwhile, consumer price inflation remained subdued. In spite of these largely positive developments, participants at the November meeting noted that they were unsure how much of the recent firming in final demand reflected the effects of temporary fiscal programs. Downside risks to economic activity included continued weakness in the labor market and its implications for the growth of household income and consumer confidence. Bank credit remained tight. Nonetheless, policymakers expected the recovery to continue in subsequent quarters, although at a pace that would be rather slow relative to historical experience after severe downturns. FOMC participants noted the possibility that some negative side effects might result from the maintenance of very low short-term interest rates for an extended period, including the possibility that such a policy stance could lead to excessive risk-taking in financial markets or an unanchoring of inflation expectations. The Committee agreed that it was important to remain alert to these risks.

Based on this outlook, the Committee decided to maintain the target range for the federal funds rate at 0 to ¼ percent and noted that economic conditions, including low levels of resource utilization, subdued inflation trends, and stable inflation expectations, were likely to warrant exceptionally low rates for an extended period. With respect to the large-scale asset purchase programs, the Committee reiterated its intention to purchase $1.25 trillion of agency MBS by the end of the first quarter of 2010. Because of the limited availability of agency debt and concerns that larger purchases could impair market functioning, the Committee also agreed to specify that its agency debt purchases would cumulate to about $175 billion by the end of the first quarter, $25 billion less than the previously announced maximum for these purchases. The Committee also decided to reiterate its intention to gradually slow the pace of purchases of agency MBS and agency debt to promote a smooth transition in markets as the announced purchases are completed.

On November 17, the Board of Governors announced that, in light of continued improvement in financial market conditions, in January 2010 the maximum maturity of primary credit loans at the discount window for depository institutions would be reduced to 28 days from 90 days.

The information reviewed at the December 15–16 FOMC meeting suggested that the recovery in economic activity was gaining momentum. Although the unemployment rate remained very elevated and capacity utilization low, the pace of job losses had slowed noticeably since the summer, and industrial production had sustained the broad-based expansion that began in the third quarter. Consumer spending expanded solidly in October. Sales of new homes had risen in October after two months of little change, while sales of existing homes continued to increase strongly. Financial market conditions were generally regarded as having become more supportive of continued economic recovery during the intermeeting period. A jump in energy prices pushed up headline inflation somewhat, but core consumer price inflation remained subdued. Although some of the recent data had been better than anticipated, policymakers generally saw the incoming information as broadly in line with their expectations for a moderate economic recovery and subdued inflation. Consistent with experience following previous financial crises here and abroad, FOMC participants broadly anticipated that the pickup in output and employment would be rather slow relative to past recoveries from deep recessions.

The Committee made no changes to either its large-scale asset purchase programs or its target range for the federal funds rate of 0 to ¼ percent and, based on the outlook for a relatively sluggish economic recovery, decided to reiterate its anticipation that economic conditions, including low levels of resource utilization, subdued inflation trends, and stable inflation expectations, were likely to warrant exceptionally low rates for an extended period. Committee members and Board members agreed that substantial improvements in the functioning of financial markets had occurred; accordingly, they agreed that the statement to be released following the meeting should note the anticipated expiration of most of the Federal Reserve's special liquidity facilities on February 1, 2010.

At the January 26–27 meeting, the Committee agreed that the incoming information, though mixed, indicated that overall economic activity had strengthened in recent months, about as expected. Consumer spending was well maintained in the fourth quarter, and business expenditures on equipment and software appeared to expand substantially. However, the improvement in the housing market slowed, and spending on nonresidential structures continued to fall. Recent data suggested that the pace of inventory liquidation diminished considerably last quarter, providing a sizable boost to economic activity. Indeed, industrial production advanced at a solid rate in the fourth quarter. In the labor market, layoffs subsided noticeably in the final months of last year, but the unemployment rate remained elevated and hiring stayed quite limited. The weakness in labor

Federal Reserve Initiatives to Increase Transparency

Transparency is a key tenet of modern central banking both because it contributes importantly to the accountability of central banks to the government and the public and because it can enhance the effectiveness of central banks in achieving their macroeconomic objectives. In recognition of the importance of transparency, the Federal Reserve has provided detailed information on the nontraditional policy actions taken to address the financial crisis, and generally aims to maximize the amount of information it can provide to the public consistent with its broad policy objectives.

The Federal Reserve has significantly enhanced its transparency in a number of important dimensions over recent years. On matters related to the conduct of monetary policy, the Federal Reserve has long been one of the most transparent central banks in the world. Following each of its meetings, the Federal Open Market Committee (FOMC) releases statements that provide a rationale for the policy decision, along with a record of the Committee's vote and explanations for any dissents. In addition, detailed minutes of each FOMC meeting are made public three weeks following the meeting. The minutes provide a great deal of information about the range of policymakers' views on the economic situation and outlook as well as on their deliberations about the appropriate stance of monetary policy. Recently, the Federal Reserve further advanced transparency by initiating a quarterly Summary of Economic Projections of Federal Reserve Board members and Reserve Bank presidents. These projections and the accompanying summary analysis contain detailed information regarding policymakers' views about the future path of real gross domestic product, inflation, and unemployment, including the long-run values of these variables assuming appropriate monetary policy.[1]

During the financial crisis, the Federal Reserve implemented a number of credit and liquidity programs to support the functioning of key financial markets and institutions and took complementary steps to ensure appropriate transparency and accountability in operating these programs. The Board's weekly H.4.1 statistical release has been greatly expanded to provide detailed information on the Federal Reserve's balance sheet and the operation of the various credit and liquidity facilities.[2] The release is closely watched in financial markets and by the public for nearly real-time information on the evolution of the Federal Reserve's balance sheet.

The Federal Reserve also developed a public website focused on its credit and liquidity programs that provides background information on all the facilities.[3] In addition, starting in December 2008 the Federal Reserve has issued

1. FOMC statements and minutes, the Summary of Economic Projections, and other related information are available on the Federal Reserve Board's website. See Board of Governors of the Federal Reserve System, "Federal Open Market Committee," webpage, www.federalreserve.gov/monetarypolicy/fomc.htm.

2. Board of Governors of the Federal Reserve System, Statistical Release H.4.1, "Factors Affecting Reserve Balances," webpage, www.federalreserve.gov/releases/h41.

3. Board of Governors of the Federal Reserve System, "Credit and Liquidity Programs and the Balance Sheet," webpage, www.federalreserve.gov/monetarypolicy/bst.htm.

Federal Reserve Initiatives—continued

bi-monthly reports to the Congress in fulfillment of section 129 of the Emergency Economic Stabilization Act of 2008; in October 2009, the Federal Reserve began incorporating these reports into its monthly report on credit and liquidity programs and the balance sheet.[4] The monthly report, which is available on the Federal Reserve's website, provides more-detailed information on the full range of credit and liquidity programs implemented during the crisis. This report includes data on the number and types of borrowers using various facilities and on the types and value of collateral pledged; information on the assets held in the so-called Maiden Lane facilities—created to acquire certain assets of The Bear Stearns Companies, Inc., and of American International Group, Inc. (AIG)—and in other special lending facilities; and quarterly financial statements for the Federal Reserve System. Furthermore, the monthly reports provide detailed information on all of the programs that rely on emergency lending authorities, including the Federal Reserve's assessment of the expected cost to the Federal Reserve and the U.S. taxpayer of various Federal Reserve programs implemented during the crisis. To provide further transparency regarding its transactions with AIG, the Federal Reserve recently indicated that it would welcome a full review by the Government Accountability Office of all aspects of the Federal Reserve's involvement with the extension of credit to AIG.[5]

4. Board of Governors of the Federal Reserve System, Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet (Washington: Board of Governors).

5. Ben S. Bernanke (2010), letter to Gene L. Dodaro, January 19, www.federalreserve.gov/monetarypolicy/files/letter_aig_20100119.pdf.

The Federal Reserve has also been transparent about the management of its programs. Various programs employ private-sector firms as purchasing and settlement agents and to perform other functions; the contracts for all of these vendor arrangements are available on the website of the Federal Reserve Bank of New York.[6] Moreover, the Federal Reserve has recently begun to publish detailed CUSIP-number-level data regarding its holdings of Treasury, agency, and agency mortgage-backed securities; these data provide the public with precise information about the maturity and asset composition of the Federal Reserve's securities holdings.[7] On January 11, 2010, the Federal Reserve Bank of New York published a revised policy governing the designation of primary dealers.[8] An important motivation in issuing revised guidance in this area was to make the process for becoming a primary dealer more transparent.

6. Federal Reserve Bank of New York, "Vendor Information," webpage, www.newyorkfed.org/aboutthefed/vendor_information.html.

7. Federal Reserve Bank of New York, "System Open Market Account Holdings," webpage, www.newyorkfed.org/markets/soma/sysopen_accholdings.html.

CUSIP is the abbreviation for Committee on Uniform Securities Identification Procedures. A CUSIP number identifies most securities, including stocks of all registered U.S. and Canadian companies and U.S. government and municipal bonds. The CUSIP system—owned by the American Bankers Association and operated by Standard & Poor's—facilitates the clearing and settlement process of securities.

8. Federal Reserve Bank of New York (2010), "New York Fed Publishes Revised Policy for Administration of Primary Dealer Relationships," press release, January 11, www.newyorkfed.org/newsevents/news/markets/2010/ma100111.html.

markets continued to be an important concern for the Committee; moreover, the prospects for job growth remained a significant source of uncertainty in the economic outlook, particularly in the outlook for consumer spending. Financial market conditions were supportive of economic growth. However, net debt financing by nonfinancial businesses was near zero in the fourth quarter after declining in the third, consistent with sluggish demand for credit and tight credit standards and terms at banks. Increases in energy prices pushed up headline consumer price inflation even as core consumer price inflation remained subdued.

In their discussion of monetary policy for the period ahead, the Committee agreed that neither the economic outlook nor financial conditions had changed appreciably since the December meeting and that no changes to the Committee's large-scale asset purchase programs or to its target range for the federal funds rate of 0 to ¼ percent were warranted at this meeting. Further, policymakers reiterated their anticipation that economic conditions, including low levels of resource utilization, subdued inflation trends, and stable inflation expectations, were likely to warrant exceptionally low rates for an extended period. The Committee affirmed its intention to purchase a total of $1.25 trillion of agency MBS and about $175 billion of agency debt by the end of the current quarter and to gradually slow the pace of these purchases to promote a smooth transition in markets. Committee members and Board members agreed that with substantial improvements in most financial markets, including interbank markets, the statement would indicate that on February 1, 2010, the Federal Reserve was closing several special liquidity facilities and that the temporary swap lines with foreign central banks would expire. In addition, the statement would say that the Federal Reserve was in the process of winding down the TAF and that the final auction would take place in March 2010.

On February 1, 2010, given the overall improvement in funding markets, the Federal Reserve allowed the Primary Dealer Credit Facility, the Term Securities Lending Facility, the Commercial Paper Funding Facility, and the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility to expire. The temporary swap lines with foreign central banks were closed on the same day. On February 18, 2010, the Federal Reserve announced a further normalization of the terms of loans made under the primary credit facility: The rate charged on these loans was increased from ½ percent to ¾ percent, effective on February 19, and the typical maximum maturity for such loans was shortened to overnight, effective on March 18, 2010. On the same day, the Federal Reserve also announced that the minimum bid rate on the final TAF auction on March 8 had been raised to 50 basis points, ¼ percentage point higher than in previous auctions. The Federal Reserve noted that the modifications are not expected to lead to tighter financial conditions for households and businesses and do not signal any change in the outlook for the economy or for monetary policy.

Over the course of 2009, the Federal Reserve continued to undertake initiatives to improve communications about its policy actions. These initiatives are described in detail in the box "Federal Reserve Initiatives to Increase Transparency."

Monetary Policy as the Economy Recovers

The actions taken by the Federal Reserve to support financial market functioning and provide extraordinary monetary stimulus to the economy have led to a rapid expansion of the Federal Reserve's balance sheet, from less than $900 billion before the crisis began in 2007 to about $2.3 trillion currently. The expansion of the Federal Reserve's balance sheet has been accompanied by a comparable increase in the quantity of reserve balances held by depository institutions. Bank reserves are currently far above their levels prior to the crisis. Even though, as noted in recent statements of the FOMC, economic conditions are likely to warrant exceptionally low rates for an extended period, in due course, as the expansion matures, the Federal Reserve will need to begin to tighten monetary conditions to prevent the development of inflation pressures. That tightening will be accomplished partly through changes that will affect the composition and size of the Federal Reserve's balance sheet. Eventually, the level of reserves and the size of the Federal Reserve's balance sheet will be reduced substantially.

The Federal Reserve has a number of tools that will enable it to firm the stance of policy at the appropriate time and to the appropriate degree, some of which do not affect the size of the balance sheet or the quantity of reserves. Most importantly, in October 2008 the Congress gave the Federal Reserve statutory authority to pay interest on banks' holdings of reserve balances at Federal Reserve Banks. By increasing the interest rate paid on reserves, the Federal Reserve will be able to put significant upward pressure on all short-term interest rates, because banks will not supply short-term funds to the money markets at rates significantly below what they can earn by simply leaving funds on deposit at the Federal Reserve Banks. Actual and prospective increases in short-term interest rates will be reflected, in turn, in longer-term interest rates and in financial conditions more generally through standard transmission mechanisms, thus preventing inflationary pressures from developing.

The Federal Reserve has also been developing a number of additional tools that will reduce the quantity of reserves held by the banking system and lead to a tighter relationship between the interest rate that the Federal Reserve pays on banks' holdings of reserve balances and other short-term interest rates. Reverse repurchase agreements (reverse repos) are one such tool; in a reverse repo, the Federal Reserve sells a security to a counterparty with an agreement to repurchase it at some specified date in the future. The counterparty's payment to the Federal Reserve has the effect of draining an equal quantity of reserves from the banking system. Recently, by developing the capacity to conduct such transactions in the triparty repo market, the Federal Reserve has enhanced its ability to use reverse repos to absorb very large quantities of reserves. The capability to carry out these transactions with primary dealers, using the Federal Reserve's holdings of Treasury and agency debt securities, has already been tested and is currently available if and when needed. To further increase its capacity to drain reserves through reverse repos, the Federal Reserve is also in the process of expanding the set of counterparties with which it can transact and is developing the infrastructure necessary to use its MBS holdings as collateral in these transactions.

As a second means of draining reserves, the Federal Reserve is also developing plans to offer to depository institutions term deposits, which are roughly analogous to certificates of deposit that the institutions offer to their customers. The Federal Reserve would likely offer large blocks of such deposits through an auction mechanism. The effect of these transactions would be to convert a portion of depository institutions' holdings of reserve balances into deposits that could not be used to meet depository institutions' very short-term liquidity needs and could not be counted as reserves. The Federal Reserve published in the *Federal Register* a proposal for such a term deposit facility and is in the process of reviewing the public comments received. After a revised proposal is approved by the Board, the Federal Reserve expects to be able to conduct test transactions in the spring and to have the facility available if necessary shortly thereafter. Reverse repos and the deposit facility would together allow the Federal Reserve to drain hundreds of billions of dollars of reserves from the banking system quite quickly should it choose to do so.

The Federal Reserve also has the option of redeeming or selling securities as a means of applying monetary restraint. A reduction in securities holdings would have the effect of further reducing the quantity of reserves in the banking system as well as reducing the overall size of the Federal Reserve's balance sheet. It would likely also put at least some direct upward pressure on longer-term yields.

The Treasury's temporary Supplementary Financing Program (SFP)—through which the Treasury issues Treasury bills to the public and places the proceeds in a special deposit account at the Federal Reserve—could also be used to drain reserves and support the Federal Reserve's control of short-term interest rates. However, the use of the SFP must be compatible with the Treasury's debt-management objectives. The SFP is not a necessary element in the Federal Reserve's set of tools to achieve an appropriate monetary policy stance in the future; still, any amount outstanding under the SFP will result in a corresponding decrease in the quantity of reserves in the banking system, which could be helpful in the Federal Reserve's conduct of policy.

The exact sequence of steps and combination of tools that the Federal Reserve chooses to employ as it exits from its current very accommodative policy stance will depend on economic and financial developments. One possible trajectory would be for the Federal Reserve to continue to test its tools for draining reserves on a limited basis in order to further ensure preparedness and to give market participants a period of time to become familiar with their operation. As the time for the removal of policy accommodation draws near, those operations could be scaled up to drain more-significant volumes of reserve balances to provide tighter control over short-term interest rates. The actual firming of policy would then be implemented through an increase in the interest rate paid on reserves. If economic and financial developments were to require a more rapid exit from the current highly accommodative policy, however, the Federal Reserve could increase the interest rate on reserves at about the same time it commences draining operations.

The Federal Reserve currently does not anticipate that it will sell any of its securities holding in the near term, at least until after policy tightening has gotten under way and the economy is clearly in a sustainable recovery. However, to help reduce the size of its balance sheet and the quantity of reserves, the Federal Reserve is allowing agency debt and MBS to run off as they mature or are prepaid. The Federal Reserve is rolling over all maturing Treasury securities, but in the future it might decide not to do so in all cases. In the long run, the Federal Reserve anticipates that its balance sheet will shrink toward more historically normal levels and that most or all of its securities holdings will be Treasury securities. Although passively redeeming agency debt and MBS as they mature or are prepaid will move the Federal Reserve in that direction, the Federal Reserve may also choose to sell securities in the future when the economic recovery is sufficiently advanced and the FOMC has determined that the associated financial tightening is warranted. Any such sales would be gradual, would be clearly communicated to market participants, and would entail appropriate consideration of economic conditions.

As a result of the very large volume of reserves in the banking system, the level of activity and liquidity in the federal funds market has declined considerably, raising the possibility that the federal funds rate could for a time become a less reliable indicator than usual of conditions in short-term money markets. Accordingly, the Federal Reserve is considering the utility, during the transition to a more normal policy configuration, of communicating the stance of policy in terms of another operating target, such as an alternative short-term interest rate. In particular, it is possible that the Federal Reserve could for a time use the interest rate paid on reserves, in combination with targets for reserve quantities, as a guide to its policy stance, while simultaneously monitoring a range of market rates. No decision has been made on this issue, and any deliberation will be guided in part by the evolution of the federal funds market as policy accommodation is withdrawn. The Federal Reserve anticipates that it will eventually return to an operating framework with much lower reserve balances than at present and with the federal funds rate as the operating target for policy.

Part 4 Summary of Economic Projections

The following material appeared as an addendum to the minutes of the January 26–27, 2010, meeting of the Federal Open Market Committee.

In conjunction with the January 26–27, 2010, FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in deliberations of the FOMC, submitted projections for output growth, unemployment, and inflation for the years 2010 to 2012 and over the longer run. The projections were based on information available through the end of the meeting and on each participant's assumptions about factors likely to affect economic outcomes, including his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future path of policy that the participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her interpretation of the Federal Reserve's dual objectives of maximum employment and stable prices. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

FOMC participants' forecasts for economic activity and inflation were broadly similar to their previous projections, which were made in conjunction with the November 2009 FOMC meeting. As depicted in figure 1, the economic recovery from the recent recession was expected to be gradual, with real gross domestic product (GDP) expanding at a rate that was only moderately above participants' assessment of its longer-run sustainable growth rate and the unemployment rate declining slowly over the next few years. Most participants also anticipated that inflation would remain subdued over this period. As indicated in table 1, a few participants made modest upward revisions to their projections for real GDP growth in 2010. Beyond 2010, however, the contours of participants' projections for economic activity and inflation were little changed, with participants continuing to expect that the pace of the economic recovery will be restrained by household and business uncertainty, only gradual improvement in labor market conditions, and slow easing of credit conditions in the banking sector. Participants generally expected that it would take some time for the economy to converge fully to its longer-run path—characterized by a sustainable rate of output growth and by rates of employment and inflation consistent with their interpretation of the Federal Reserve's dual objectives—with a sizable minority of the view that the convergence process could take more than five to six years. As in November, nearly all participants judged the risks to their growth outlook as generally balanced, and most also saw roughly balanced risks surrounding their inflation projections. Participants continued to judge the uncertainty surrounding their projections for economic

Table 1. Economic Projections of Federal Reserve Governors and Reserve Bank Presidents, January 2010

Percent

Variable	Central tendency[1]				Range[2]			
	2010	2011	2012	Longer run	2010	2011	2012	Longer run
Change in real GDP	2.8 to 3.5	3.4 to 4.5	3.5 to 4.5	2.5 to 2.8	2.3 to 4.0	2.7 to 4.7	3.0 to 5.0	2.4 to 3.0
November projection	2.5 to 3.5	3.4 to 4.5	3.5 to 4.8	2.5 to 2.8	2.0 to 4.0	2.5 to 4.6	2.8 to 5.0	2.4 to 3.0
Unemployment rate	9.5 to 9.7	8.2 to 8.5	6.6 to 7.5	5.0 to 5.2	8.6 to 10.0	7.2 to 8.8	6.1 to 7.6	4.9 to 6.3
November projection	9.3 to 9.7	8.2 to 8.6	6.8 to 7.5	5.0 to 5.2	8.6 to 10.2	7.2 to 8.7	6.1 to 7.6	4.8 to 6.3
PCE inflation	1.4 to 1.7	1.1 to 2.0	1.3 to 2.0	1.7 to 2.0	1.2 to 2.0	1.0 to 2.4	0.8 to 2.0	1.5 to 2.0
November projection	1.3 to 1.6	1.0 to 1.9	1.2 to 1.9	1.7 to 2.0	1.1 to 2.0	0.6 to 2.4	0.2 to 2.3	1.5 to 2.0
Core PCE inflation[3]	1.1 to 1.7	1.0 to 1.9	1.2 to 1.9		1.0 to 2.0	0.9 to 2.4	0.8 to 2.0	
November projection	1.0 to 1.5	1.0 to 1.6	1.0 to 1.7		0.9 to 2.0	0.5 to 2.4	0.2 to 2.3	

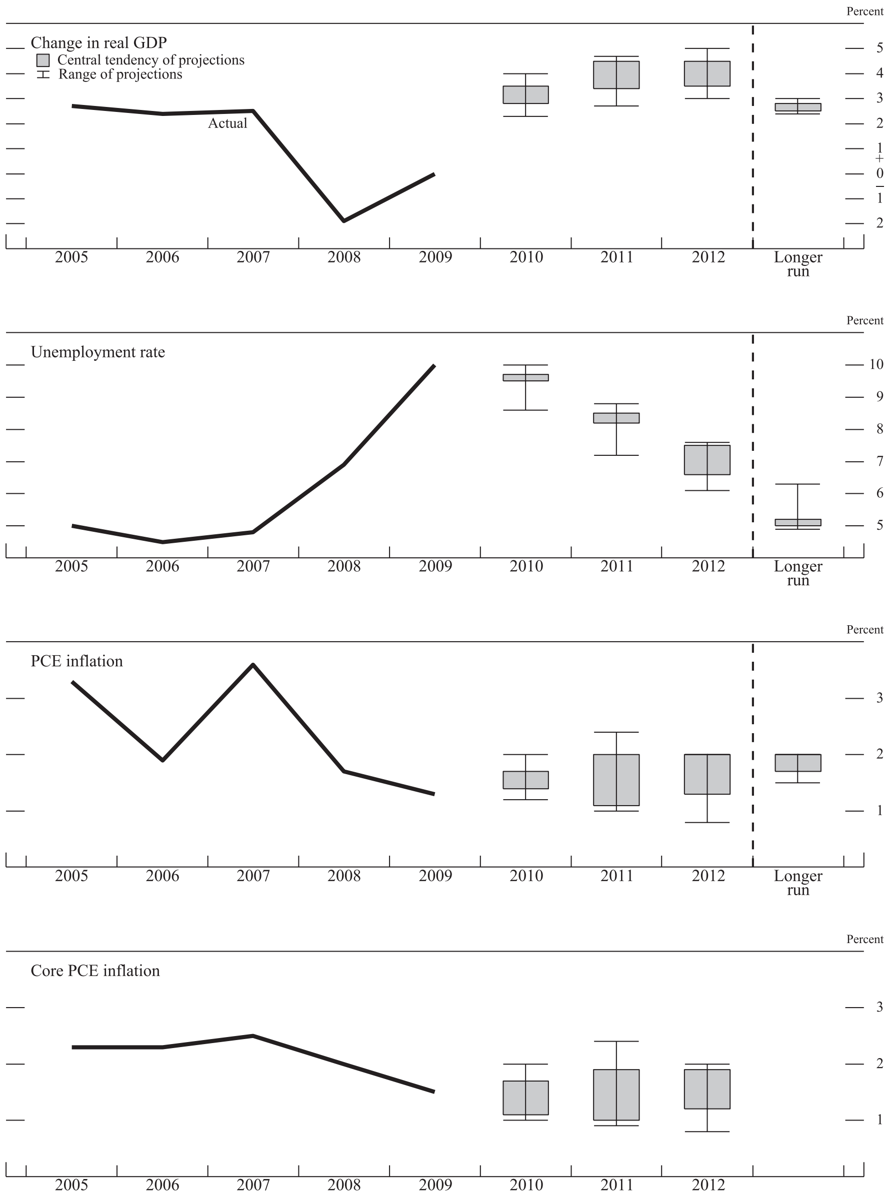
NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The November projections were made in conjunction with the meeting of the Federal Open Market Committee on November 3–4, 2009.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.

2. The range for a variable in a given year consists of all participants' projections, from lowest to highest, for that variable in that year.

3. Longer-run projections for core PCE inflation are not collected.

Figure 1. Central Tendencies and Ranges of Economic Projections, 2010–12 and over the Longer Run



Note: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual. The data for the change in real GDP, PCE inflation, and core PCE inflation shown for 2009 incorporate the advance estimate of GDP for the fourth quarter of 2009, which the Bureau of Economic Analysis released on January 29, 2010; this information was not available to FOMC meeting participants at the time of their meeting.

activity and inflation as unusually high relative to historical norms.

The Outlook

Participants' projections for real GDP growth in 2010 had a central tendency of 2.8 to 3.5 percent, a somewhat narrower interval than in November. Recent readings on consumer spending, industrial production, and business outlays on equipment and software were seen as broadly consistent with the view that economic recovery was under way, albeit at a moderate pace. Businesses had apparently made progress in bringing their inventory stocks into closer alignment with sales and hence would be likely to raise production as spending gained further momentum. Participants pointed to a number of factors that would support the continued expansion of economic activity, including accommodative monetary policy, ongoing improvements in the conditions of financial markets and institutions, and a pickup in global economic growth, especially in emerging market economies. Several participants also noted that fiscal policy was currently providing substantial support to real activity, but said that they expected less impetus to GDP growth from this factor later in the year. Many participants indicated that the expansion was likely to be restrained not only by firms' caution in hiring and spending in light of the considerable uncertainty regarding the economic outlook and general business conditions, but also by limited access to credit by small businesses and consumers dependent on bank-intermediated finance.

Looking further ahead, participants' projections were for real GDP growth to pick up in 2011 and 2012; the projections for growth in both years had a central tendency of about 3½ to 4½ percent. As in November, participants generally expected that the continued repair of household balance sheets and gradual improvements in credit availability would bolster consumer spending. Responding to an improved sales outlook and readier access to bank credit, businesses were likely to increase production to rebuild their inventory stocks and increase their outlays on equipment and software. In addition, improved foreign economic conditions were viewed as supporting robust growth in U.S. exports. However, participants also indicated that elevated uncertainty on the part of households and businesses and the very slow recovery of labor markets would likely restrain the pace of expansion. Moreover, although conditions in the banking system appeared to have stabilized, distress in commercial real estate markets was expected to pose risks to the balance sheets of banking institutions for some time, thereby contributing to only gradual easing of credit conditions for many households and smaller firms. In the absence of further shocks, participants generally anticipated that real GDP growth would converge over time to an annual rate of 2.5 to 2.8 percent, the longer-run pace that appeared to be sustainable in view of expected demographic trends and improvements in labor productivity.

Participants anticipated that labor market conditions would improve only slowly over the next several years. Their projections for the average unemployment rate in the fourth quarter of 2010 had a central tendency of 9.5 to 9.7 percent, only a little below the levels of about 10 percent that prevailed late last year. Consistent with their outlook for moderate output growth, participants generally expected that the unemployment rate would decline only about 2½ percentage points by the end of 2012 and would still be well above its longer-run sustainable rate. Some participants also noted that considerable uncertainty surrounded their estimates of the productive potential of the economy and the sustainable rate of employment, owing partly to substantial ongoing structural adjustments in product and labor markets. Nonetheless, participants' longer-run unemployment projections had a central tendency of 5.0 to 5.2 percent, the same as in November.

Most participants anticipated that inflation would remain subdued over the next several years. The central tendency of their projections for personal consumption expenditures (PCE) inflation was 1.4 to 1.7 percent for 2010, 1.1 to 2.0 percent for 2011, and 1.3 to 2.0 percent for 2012. Many participants anticipated that global economic growth would spur increases in energy prices, and hence that headline PCE inflation would run slightly above core PCE inflation over the next year or two. Most expected that substantial resource slack would continue to restrain cost pressures, but that inflation would rise gradually toward their individual assessments of the measured rate of inflation judged to be most consistent with the Federal Reserve's dual mandate. As in November, the central tendency of projections of the longer-run inflation rate was 1.7 to 2.0 percent. A majority of participants anticipated that inflation in 2012 would still be below their assessments of the mandate-consistent inflation rate, while the remainder expected that inflation would be at or slightly above its longer-run value by that time.

Uncertainty and Risks

Nearly all participants shared the judgment that their projections of future economic activity and unemployment continued to be subject to greater-than-average uncertainty.[19] Participants generally saw the risks to these projections as roughly balanced, although a few indicated that the risks to the unemployment outlook remained tilted to the upside. As in November, many participants highlighted the difficulties inherent in predicting macroeconomic outcomes in the wake of a financial crisis and a severe recession. In addition, some pointed to uncertainties regarding the extent to which the recent run-up in labor productivity would prove to be persistent, while others noted the risk that the deteriorating performance of commercial real estate could adversely affect the still-fragile state of the banking system and restrain the growth of output and employment over coming quarters.

As in November, most participants continued to see the uncertainty surrounding their inflation projections as higher than historical norms. However, a few judged that uncertainty in the outlook for inflation was about in line with typical levels, and one viewed the uncertainty surrounding the inflation outlook as lower than average. Nearly all participants judged the risks to the inflation outlook as roughly balanced; however, two saw these risks as tilted to the upside, while one regarded the risks as weighted to the downside. Some participants noted that inflation expectations could drift downward in response to persistently low inflation

19. Table 2 provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1989 to 2008. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risk attending participants' projections.

Table 2. Average Historical Projection Error Ranges

Percentage points

Variable	2010	2011	2012
Change in real GDP[1]	±1.3	±1.5	±1.6
Unemployment rate[1]	±0.6	±0.8	±1.0
Total consumer prices[2]	±0.9	±1.0	±1.0

NOTE: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1989 through 2008 that were released in the winter by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1. For definitions, refer to general note in table 1.

2. Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

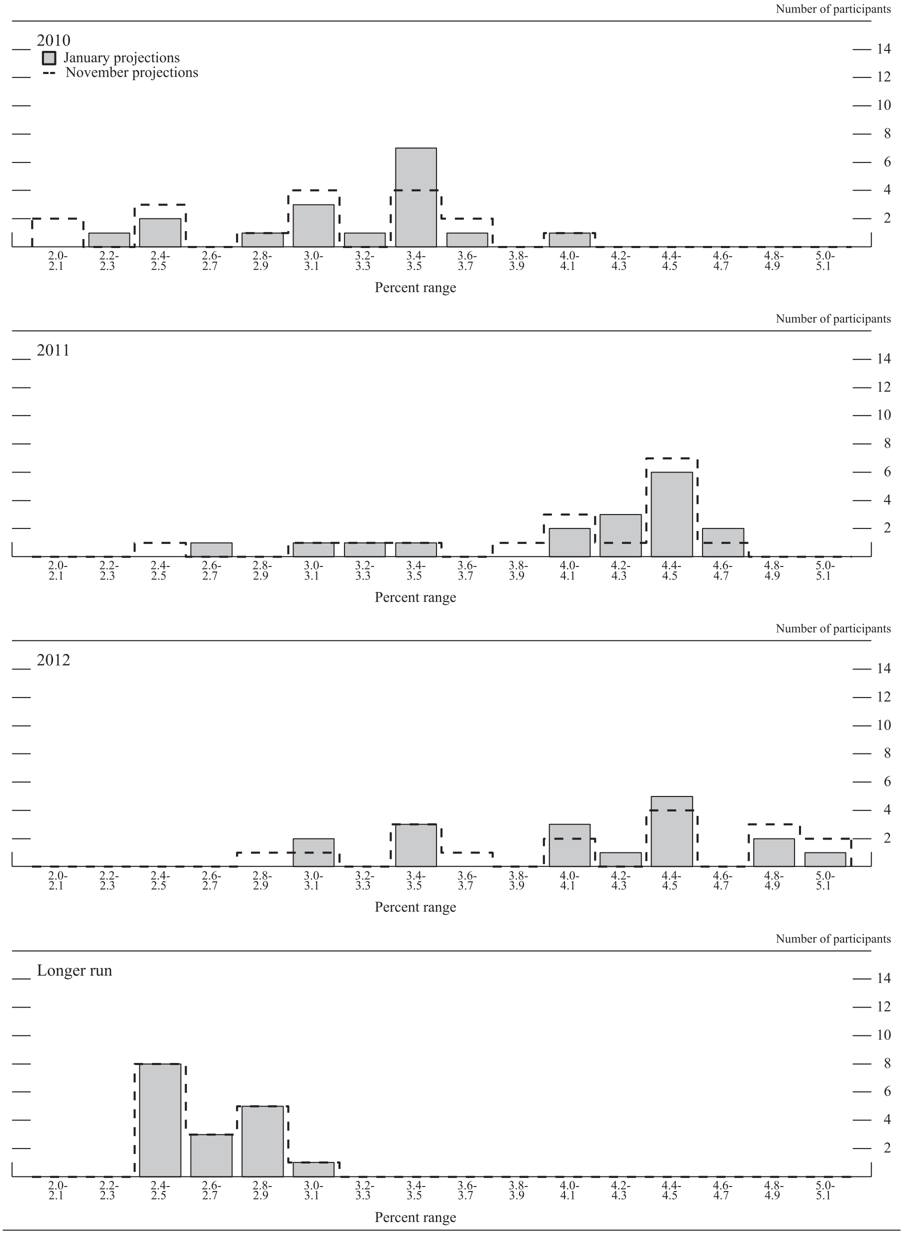
and continued slack in resource utilization. Others pointed to the possibility of an upward shift in expected and actual inflation, especially if extraordinarily accommodative monetary policy measures were not unwound in a timely fashion. Participants also noted that an acceleration in global economic activity could induce a surge in the prices of energy and other commodities that would place upward pressure on overall inflation.

Diversity of Views

Figures 2.A and 2.B provide further details on the diversity of participants' views regarding the likely outcomes for real GDP growth and the unemployment rate in 2010, 2011, 2012, and over the longer run. The distribution of participants' projections for real GDP growth this year was slightly narrower than the distribution of their projections last November, but the distributions of the projections for real GDP growth in 2011 and in 2012 were little changed. The dispersion in participants' output growth projections reflected, among other factors, the diversity of their assessments regarding the current degree of underlying momentum in economic activity, the evolution of consumer and business sentiment, and the likely pace of easing of bank lending standards and terms. Regarding participants' unemployment rate projections, the distribution for 2010 narrowed slightly, but the distributions of their unemployment rate projections for 2011 and 2012 did not change appreciably. The distributions of participants' estimates of the longer-run sustainable rates of output growth and unemployment were essentially the same as in November.

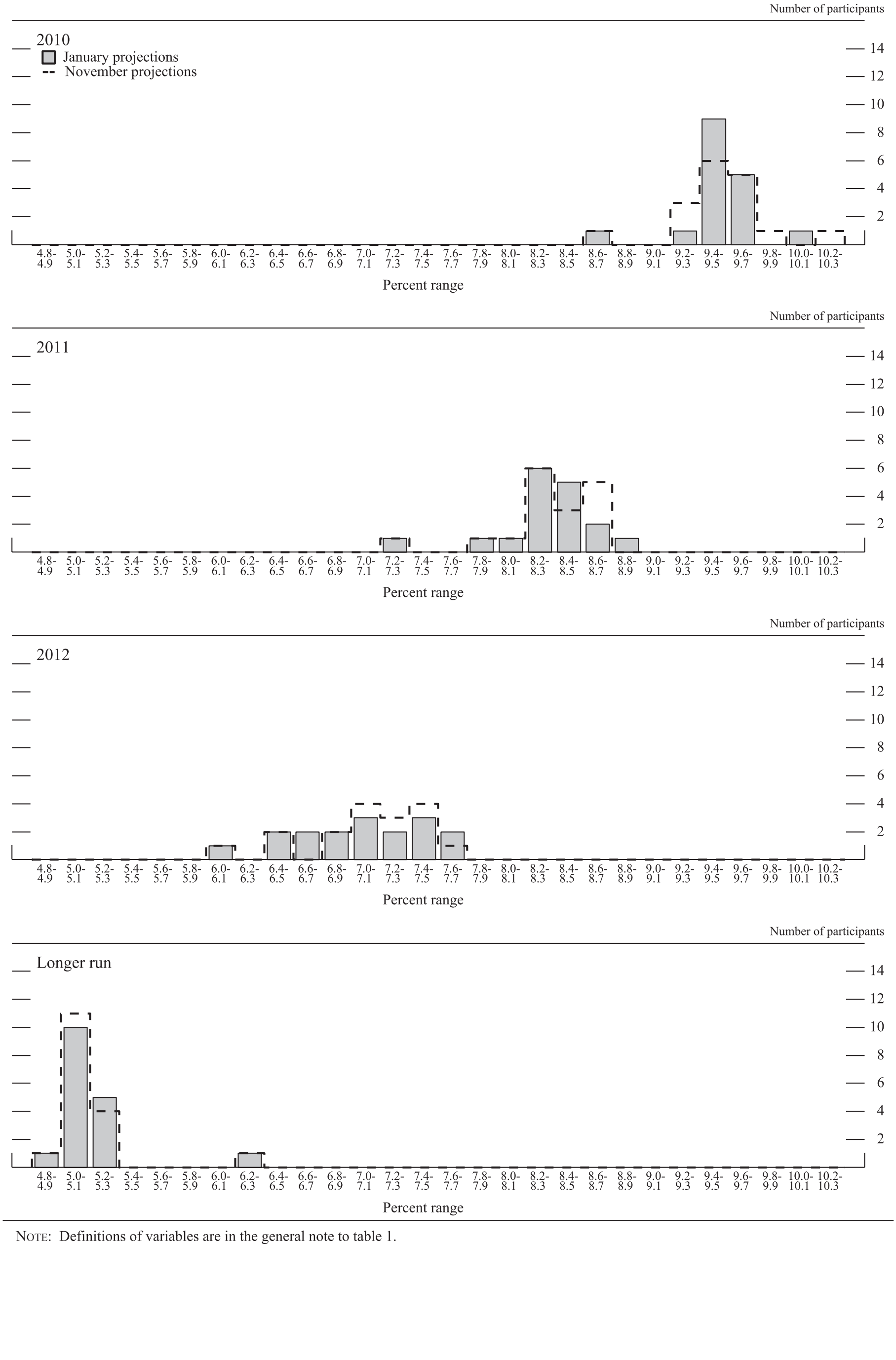
Figures 2.C and 2.D provide corresponding information about the diversity of participants' views regarding the inflation outlook. For overall and core PCE inflation, the distributions of participants' projections for 2010 were nearly the same as in November. The distributions of overall and core inflation for 2011 and 2012, however, were noticeably more tightly concentrated than in November, reflecting the absence of forecasts of especially low inflation. The dispersion in participants' projections over the next few years was mainly due to differences in their judgments regarding the determinants of inflation, including their estimates of prevailing resource slack and their assessments of the extent to which such slack affects actual and expected inflation. In contrast, the relatively tight distribution of participants' projections for longer-run inflation illustrates their substantial agreement about the measured rate of inflation that is most consistent with the Federal Reserve's dual objectives of maximum employment and stable prices.

Figure 2.A. Distribution of Participants' Projections for the Change in Real GDP, 2010–12 and over the Longer Run



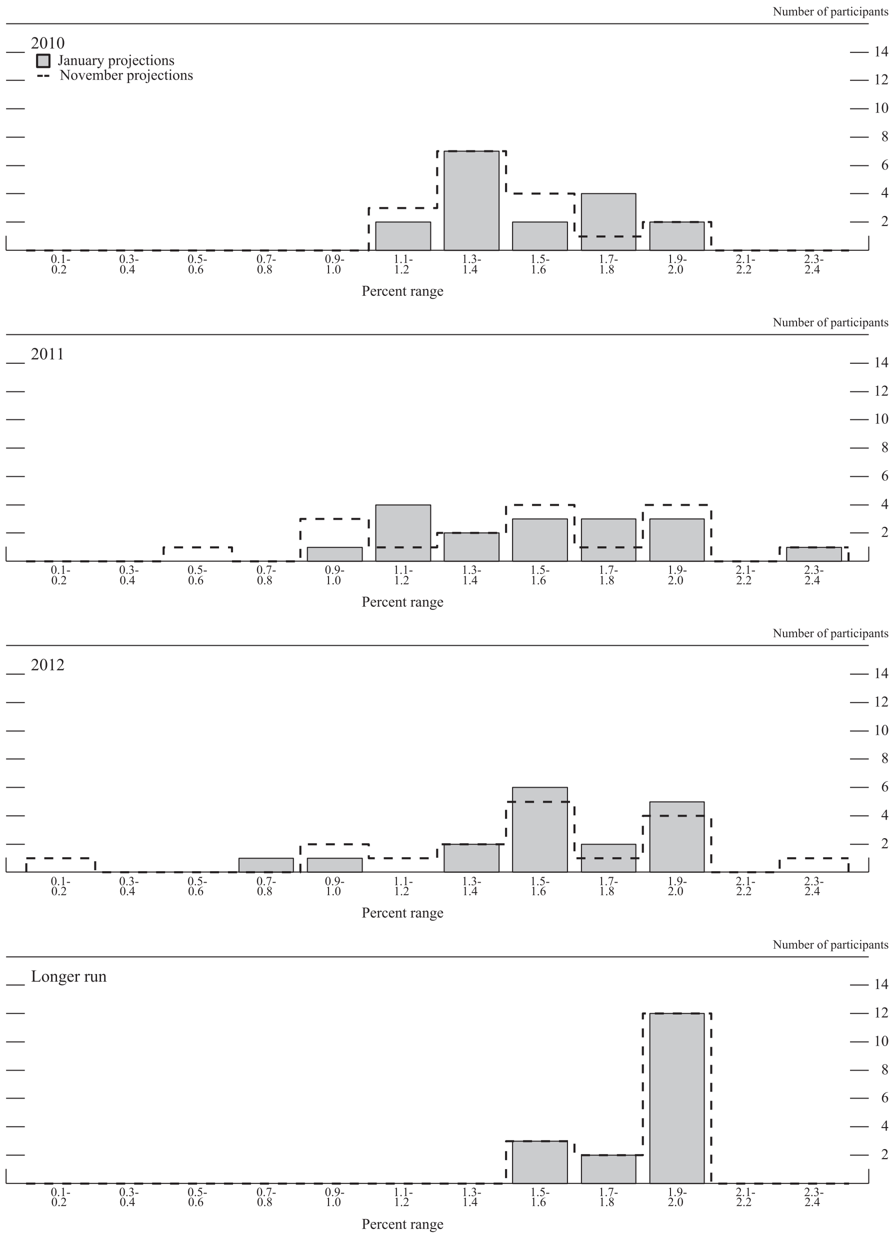
Note: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of Participants' Projections for the Unemployment Rate, 2010–12 and over the Longer Run



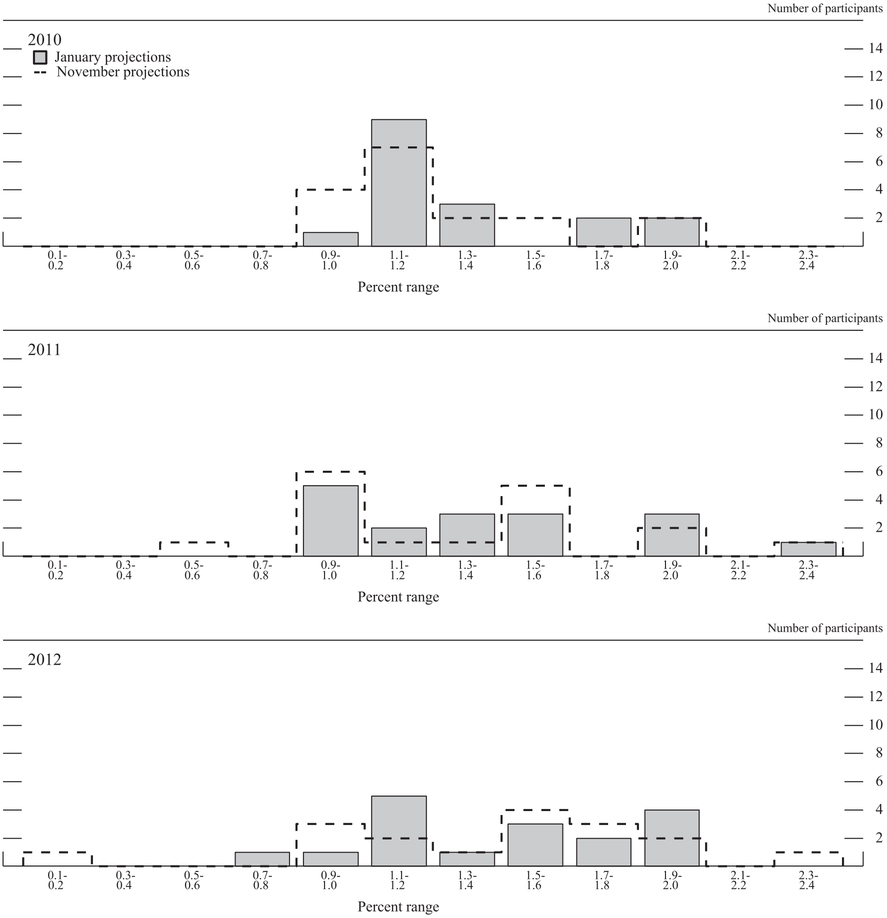
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of Participants' Projections for PCE Inflation, 2010–12 and over the Longer Run



Note: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of Participants' Projections for Core PCE Inflation, 2010–12



NOTE: Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 1.7 to 4.3 percent in the current year, 1.5 to 4.5 percent in the second year, and 1.4 to 4.6 percent in the third year. The corresponding 70 percent confidence intervals for overall inflation would be 1.1 to 2.9 percent in the current year and 1.0 to 3.0 percent in the second and third years.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

Abbreviations

ABS	asset-backed securities
AIG	American International Group, Inc.
ARRA	American Recovery and Reinvestment Act
CDS	credit default swap
C&I	commercial and industrial
CMBS	commercial mortgage-backed securities
CRE	commercial real estate
Credit CARD Act	Credit Card Accountability Responsibility and Disclosure Act
CUSIP	Committee on Uniform Securities Identification Procedures
ECB	European Central Bank
E&S	equipment and software
FAS	Financial Accounting Standards
FDIC	Federal Deposit Insurance Corporation
FHA	Federal Housing Administration
FOMC	Federal Open Market Committee; also, the Committee
GDP	gross domestic product
GSE	government-sponsored enterprise
Libor	London interbank offered rate
LLC	limited liability company
MBS	mortgage-backed securities
NFIB	National Federation of Independent Business
NIPA	national income and product accounts
OIS	overnight index swap
PCE	personal consumption expenditures
repo	repurchase agreement
SCAP	Supervisory Capital Assessment Program
SFP	Supplementary Financing Program
SLOOS	Senior Loan Officer Opinion Survey on Bank Lending Practices
TAF	Term Auction Facility
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TIPS	Treasury inflation-protected securities ■

Monetary Policy Report of July 2009

Part 1
Overview: Monetary Policy and the Economic Outlook

Amid a severe global economic downturn, the U.S. economy contracted further and labor market conditions worsened over the first half of 2009. In the early part of the year, economic activity deteriorated sharply, and strains in financial markets and pressures on financial institutions generally intensified. More recently, however, the downturn in economic activity appears to be abating and financial conditions have eased somewhat, developments that partly reflect the broad range of policy actions that have been taken to address the crisis. Nonetheless, credit conditions for many households and businesses remain tight, and financial markets are still stressed. In the labor market, employment declines have remained sizable—although the pace of job loss has diminished somewhat from earlier in the year—and the unemployment rate has continued to climb. Meanwhile, consumer price inflation has remained subdued.

U.S. real gross domestic product (GDP) fell sharply again in the first quarter of 2009, but the contraction in overall output looks to have moderated somewhat of late. Consumer spending—which has been supported recently by the boost to disposable income from the tax cuts and increases in various benefit payments that were implemented as part of the 2009 fiscal stimulus package—appears to be holding reasonably steady so far this year. And consumer sentiment is up from the historical lows recorded around the turn of the year. In the housing market, a leveling out of home sales and construction activity in the first half of 2009 suggests that the demand for new houses may be stabilizing following three years of steep declines. Businesses, however, have continued to cut capital spending and liquidate inventories in response to soft demand and excessive stocks. Economic activity abroad plummeted in the first quarter and has continued to fall, albeit more slowly, in recent months. Slumping foreign demand led to a sharp drop in U.S. exports during the first half of the year. However, the ongoing contraction in U.S. domestic demand triggered an even sharper drop in imports.

The further contraction in domestic economic activity during the first half of 2009 was accompanied by a significant deterioration in labor market conditions. Private-sector payroll employment fell at an average monthly rate of 670,000 jobs in the first four months of this year before declining by 312,000 jobs in May and 415,000 jobs in June. Meanwhile, the unemployment rate moved up steadily from 7¼ percent at the turn of the year to 9½ percent in June. With the sharp reductions in em-

Note: The discussion in this chapter consists of the text and tables from parts 1–3 of the Monetary Policy Report submitted to Congress on July 21, 2009 (the figures from that report are available on the Board's website, at www.federalreserve.gov/boarddocs/hh). Part 4 of that report is identical to the addendum to the minutes of the June 23–24, 2009, meeting of the Federal Open Market Committee and is presented with those minutes in the "Records" section of this annual report.

ployment, the wage and salary incomes of households, adjusted for price changes, fell during this period.

Overall consumer price inflation, which slowed sharply late last year, remained subdued in the first half of this year as the margin of slack in labor and product markets widened considerably further and as prices of oil and other commodities retraced only a part of their earlier steep declines. All told, the 12-month change in the personal consumption expenditures (PCE) price index was close to zero in May, while the 12-month change in PCE prices excluding food and energy was 1¾ percent. Survey measures of longer-term inflation expectations have remained relatively stable this year and currently stand at about their average values in 2008.

During the first few months of 2009, pressures on financial firms, which had eased late last year, intensified again. Equity prices of banks and insurance companies fell amid reports of large losses in the fourth quarter of 2008, and market-based measures of the likelihood of default by those institutions rose. Broad equity price indexes also fell in the United States and abroad, and measures of volatility in such markets stayed at near-record levels. In addition, bank funding markets were strained, flows of credit to businesses and households were impaired, and many securitization markets remained shut.

The Federal Reserve and other government entities continued to respond forcefully to these adverse financial market developments. The Federal Reserve kept its target for the federal funds rate at a range between 0 and ¼ percent and purchased additional agency mortgage-backed securities (MBS) and agency debt. Throughout the first half of the year, the Federal Reserve also continued to provide funding to financial institutions and markets through a variety of credit and liquidity facilities. In February, the Treasury, the Federal Reserve, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision announced the Financial Stability Plan. The plan included, among other elements, a Capital Assistance Program designed to assess the capital needs of banking institutions under a range of economic scenarios (through the Supervisory Capital Assessment Program (SCAP), or stress test) and, if necessary, to assist banking institutions in strengthening the amount and quality of their capital. In early March, the Federal Reserve and the Treasury launched the Term Asset-Backed Securities Loan Facility (TALF), an initiative designed to catalyze the securitization markets by providing financing to investors to support their purchases of certain AAA-rated asset-backed securities. At the March meeting of the Federal Open Market Committee (FOMC), the Committee decided to expand its purchases of agency MBS and agency debt and to begin buying longer-term Treasury securities to help improve conditions in private credit markets. In May, the Federal Reserve announced an expansion of eligible collateral under the TALF program. In the same month, the results of the SCAP were announced and were positively received in financial markets.

These policy actions, and ones previously taken, have helped stabilize a number of financial markets and, in some cases, have led to significant improvements. In recent months, strains in short-term funding markets have eased, with some credit spreads in those markets returning close to precrisis levels. The narrowing in spreads likely reflects, in part, a decrease in the probability that market participants assign to extremely adverse outcomes for the economy in light of the apparent moderation in the rate of economic contraction. Global equity prices have recouped some of their earlier declines, and measures of volatility in equity and other financial markets have retreated somewhat, though they remain at elevated levels. Issuance in some securitization markets that were essentially shut down earlier has begun to increase. Although yields on longer-term Treasury securities have risen, some of these increases are likely attributable to improvement in the economic outlook and a reversal in flight-to-quality flows. Mortgage rates have risen about in line with Treasury yields, but corporate bond yields have continued to decline. By early June, the 10 banking organizations required by the SCAP to bolster their capital buffers had issued new common equity in amounts that either met or came close to meeting the SCAP requirements. Nonetheless, despite these notable improvements, strains remain in most financial markets, many financial institutions face the possibility of significant additional losses, and the flow of credit to some businesses and households remains constrained.

In conjunction with the June 2009 FOMC meeting, the members of the Board of Governors of the Federal Reserve System and presidents of the Federal Reserve Banks, all of whom participate in FOMC meetings, provided projections for economic growth, unemployment, and inflation; these projections are presented in Part 4 of this report. FOMC participants generally viewed the outlook for the economy as having improved modestly in recent months. Participants expected real GDP to bottom out in the second half of this year and then to move onto a path of gradual recovery, bolstered by an accommodative monetary policy, government efforts to stabilize financial markets, and fiscal stimulus. However, all participants expected that labor market conditions would continue to deteriorate during the remainder of this year and improve only slowly over the subsequent two years, with the unemployment rate still elevated at the end of 2011. FOMC participants expected total and core inflation to be lower in 2009 than during 2008 as a whole, in part because of the sizable amount of slack in resource utilization; inflation was forecast to remain subdued in 2010 and 2011.

Participants generally judged that the degree of uncertainty surrounding the medium-term outlook for both economic activity and inflation exceeded historical norms. Participants viewed the risks to their projections of economic growth over the medium run as either balanced or tilted to the downside, and most saw the risk to their projections of medium-run inflation as balanced. Participants also reported their assessments of the rates to which key macroeconomic variables would be expected to converge in the longer run under appropriate monetary policy and in the absence of further shocks to the economy. Most participants expected real GDP to grow in the longer run at an annual rate of about 2½ percent, the unemployment rate to be about 5 percent, and the rate of consumer price inflation to be about 2 percent.

Part 2
Recent Financial and Economic Developments

Economic activity, which fell sharply in the fourth quarter of 2008, declined at nearly the same rate in the first quarter of 2009. However, the pace of contraction appears to have moderated somewhat of late. To be sure, businesses have continued to cut back on investment spending, and firms have reacted to the abrupt rise in inventory-sales ratios around the turn of the year by cutting production and running down inventories at a more rapid pace, particularly in the motor vehicle sector. Nevertheless, consumer spending seems to have stabilized, on balance, in the first half of this year, and housing activity, while still quite depressed, has leveled off in recent months. And, while the recession abroad led to another sharp drop in export demand in the first quarter, the latest indicators suggest that the contraction in foreign activity has lessened, especially in emerging Asian economies. In the labor market, the pace of job loss has diminished in recent months from the rate earlier this year; nonetheless, employment declines have remained sizable, and the unemployment rate has risen sharply. Meanwhile, inflation remained subdued in the first half of this year.

In early 2009, strains in some financial markets appeared to intensify from the levels seen in late 2008. Market participants' concerns about major financial institutions increased, equity prices for such institutions fell, and their credit default swap (CDS) spreads widened substantially. These developments spilled over to broader markets, with equity prices falling and spreads of yields on corporate bonds over those on comparable-maturity Treasury securities moving to near-record highs. Deterioration in the functioning of many financial markets restricted the flow of credit to businesses and households.

In response to these financial market stresses, the Federal Reserve and other government entities implemented additional policy initiatives to support financial stability and promote economic recovery. Federal Reserve initiatives included expanding direct purchases of agency debt and agency mortgage-backed securities (MBS), beginning direct purchases of longer-term Treasury securities, and providing loans against consumer and other asset-backed securities (ABS).[1] Other government entities also undertook new measures to support the financial sector, including the provision of more capital to banking institutions under the Capital Purchase Program, or CPP, and the announcement of programs to help banks manage their legacy assets. In addition, the bank supervisory agencies undertook a special assessment of the capital strength of the largest U.S. banking organizations (the Supervisory Capital Assessment Program, or SCAP).

Partly as a result of these efforts, conditions in financial markets began to show signs of improvement starting in March, although they remained strained. During the subsequent few months, both equity prices of financial firms and broad equity price indexes rose, on balance, and corporate bond spreads narrowed. Firms responded by substituting longer-term financing through the corporate bond market for shorter-term funding from bank loans and commercial paper (CP). Supported by the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF), issuance of consumer ABS began to approach pre-crisis levels. Short-term interbank funding markets

1. For more information, see Board of Governors of the Federal Reserve System (2009), *Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet* (Washington: Board of Governors, July).

also showed substantial improvement, and banking institutions involved in the SCAP were able to issue significant amounts of public equity and nonguaranteed debt. However, outstanding bank loans to households and nonfinancial businesses continued to decline amid expectations that borrower credit quality would deteriorate further, risk spreads in many markets that were still quite elevated, and financial conditions that remained somewhat strained.

Domestic Developments

The Household Sector

Residential Investment and Housing Finance

Although home prices have continued to fall, the steep declines in housing demand and construction that began in late 2005 appear to be abating. Sales of existing single-family homes have flattened out at a little more than 4 million units at an annual rate since late last year, and sales of new single-family homes have been little changed since January at a bit below 350,000 units. That said, the pace of sales for both new and existing homes is still very low by historical standards.

In the single-family housing sector, starts of new units appear to have firmed of late, though they remain at a depressed level. With this restrained level of construction, months' supply of unsold new homes relative to sales has come down somewhat from its peak at the turn of the year, but it still remains quite high compared with earlier in the decade. Starts in the multifamily sector—which had held up well through the spring of 2008 even as single-family activity was plummeting—have deteriorated considerably over the past year. These declines have coincided with a substantial worsening of many of the economic and financial factors that influence construction in this sector, including reports of a pullback in the availability of credit for new projects and a sharp decline in the price of apartment buildings following a multiyear run-up.

House prices continued to fall in the first part of this year. The latest readings from national indexes show price declines for existing homes over the past 12 months in the range of 7 to 18 percent. One such measure with wide geographic coverage, the LoanPerformance repeat-sales price index, fell more than 9 percent over the 12 months ending in May and is now 20 percent below the peak that it achieved in mid-2006. Price declines have been particularly marked in areas of the country that have experienced a large number of foreclosure-related sales, such as Nevada, Florida, California, and Arizona. Lower prices improve the affordability of homeownership for potential new buyers and, all else being equal, should eventually help bolster housing demand. However, expectations of further declines in house prices can make potential buyers reluctant to enter the market. Although consumer surveys continue to suggest that a sizable portion of households expect house prices to fall in the coming year, the share of such households appears to have subsided in recent months.

With house prices still falling, conditions in the labor market deteriorating, and household financial conditions remaining weak, delinquency rates continued to rise across all categories of mortgage loans. As of April 2009, nearly 40 percent of adjustable-rate subprime loans and 15 percent of fixed-rate subprime loans were seriously delinquent.[2] In May 2009, delinquency rates for prime and near-prime loans reached about 12 percent for adjustable-rate loans and 4 percent for fixed-rate loans, representing substantial increases over the past year to historic highs.

Foreclosures also jumped in 2009. Over the last three quarters of 2008, about 600,000 homes entered the foreclosure process each quarter. During the first quarter of 2009, about 750,000 homes entered the process. The increase may be related to the expiration of temporary foreclosure moratoriums that were put in place by some state and local governments, some private firms, and the government-sponsored enterprises (GSEs) late last year. The Treasury Department has recently established the Making Home Affordable program, which encompasses several efforts designed to lower foreclosure rates. The program includes a provision to allow borrowers to refinance easily into mortgages with lower payments and a provision to encourage mortgage lenders and servicers to modify delinquent mortgages.

Interest rates on 30-year fixed-rate conforming mortgages declined during early 2009; although those rates have risen more recently, about in line with increases in Treasury rates, mortgage rates remain at historically low levels. Part of the decrease may have reflected expansion of the Federal Reserve's agency MBS purchase program. Early in the year, spreads of rates on conforming fixed-rate mortgages over long-term Treasury yields fell to their lowest levels in more than a year. Offer rates on nonconforming jumbo fixed-rate loans fell slightly but continued to be well above rates on conforming loans.[3] Although the declines in rates and spreads made borrowing relatively less expensive for those qualified for conforming mortgages, access to credit remained limited for many other borrowers. In the April 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices, a majority of respondents indicated that they had tightened standards on residential mortgages over the preceding three months, an extension of the prevailing trend in earlier quarters, that about 40 percent of banks had reduced the size of existing home equity lines of credit, and that only a few of the banks reported having made subprime loans. The secondary market for conventional mortgage loans not guaranteed by Fannie Mae or Freddie Mac remained essentially shut.

Mortgage debt outstanding was about flat in the first quarter of 2009, with the effects of the weakness in the housing market and relatively restricted access to credit offsetting the influence of lower mortgage rates. The available indicators suggest that mortgage debt likely remained very soft in the second quarter. Refinancing activity was somewhat elevated early in the year, probably due to low mortgage interest rates and the waiver of many fees and easing of many underwriting terms by the GSEs. However, such activity

2. A mortgage is defined as seriously delinquent if the borrower is 90 days or more behind in payments or the property is in foreclosure.

3. Conforming mortgages are those eligible for purchase by Fannie Mae and Freddie Mac; they must be equivalent in risk to a prime mortgage with an 80 percent loan-to-value ratio, and they cannot exceed in size the conforming loan limit. The conforming loan limit for a first mortgage on a single-family home in the contiguous United States is currently equal to the greater of $417,000 or 115 percent of the area's median house price; it cannot exceed $625,500. Jumbo mortgages are those that exceed the maximum size of a conforming loan; they are typically extended to borrowers with relatively strong credit histories.

moderated considerably when interest rates rose during the past few months.

Consumer Spending and Household Finance

Consumer spending appears to have leveled off so far this year after falling sharply in the second half of last year. Continued widespread job losses and the drag from large declines in household wealth have weighed on consumption; however, spending lately has been supported by the boost to household incomes from the fiscal stimulus package enacted in February. Measures of consumer sentiment, while still at depressed levels, have nonetheless moved up from the historical lows recorded around the turn of the year.

Real personal consumption expenditures (PCE), although variable from month to month, have essentially moved sideways since late last year. Sales of new light motor vehicles continued to contract early this year but have stabilized in recent months—at an average annual rate of 9.7 million units over the four months ending in June. Outlays on other goods, which plunged in 2008, have remained at extremely low levels, while spending on services has only edged up so far this year.

Real disposable personal income, or DPI—that is, after-tax income adjusted for inflation—has risen at an annual rate of about 9 percent so far this year, a substantial pickup from the increase of 1¼ percent posted in 2008. Gains in after-tax income have been bolstered by the tax cuts and increases in social benefit payments that were implemented as part of the 2009 fiscal stimulus package. In contrast, nominal labor income has been declining steeply. Although nominal hourly compensation has risen at a faster pace than overall prices, sizable reductions in employment and the workweek have cut deeply into total hours worked and hence overall labor compensation. With real after-tax income up appreciably in the first half of the year and consumer outlays leveling off, the personal saving rate jumped during the spring, reaching nearly 7 percent in May compared with the 1¾ percent average recorded during 2008.

Household net worth continued to fall in the first quarter of this year as a result of the ongoing declines in house prices and a further drop in equity prices. However, equity prices have recorded substantial gains since March, helping to offset continued declines in the value of real estate wealth. The recent stimulus-induced jump in real disposable income and the improvement in equity wealth since this spring apparently helped lift consumer sentiment somewhat from its earlier very low levels.

Nonmortgage consumer debt outstanding is estimated to have fallen at an annual rate of 2 percent in the first half of 2009, extending a decline that began in the final quarter of 2008. The decreases likely reflect both reduced demand for loans as a result of the restrained pace of consumer spending and a restricted supply of credit. The April 2009 Senior Loan Officer Opinion Survey showed a further tightening of standards and terms on consumer loans over the preceding three months, actions that included lowering credit limits on existing credit card accounts.

The tightening in standards and terms likely reflected, in part, concerns by financial institutions about consumer credit quality. Delinquency rates on most types of consumer lending—credit card loans, auto loans, and other nonrevolving loans—continued to rise during the first half of 2009. The increase in credit card loan delinquency rates at banks was particularly sharp, and at 6½ percent as of the end of the first quarter of 2009, such delinquencies exceeded the level reached during the 2001 recession. Household bankruptcy rates continued the upward trend that has been evident since the bankruptcy law reform in 2005; the recent increases likely reflect the deterioration in household financial conditions.

Changes in interest rates on consumer loans were mixed over the first half of the year. Auto loan rates were about flat, credit card rates ticked upward, and rates on other consumer loans showed a slight decline. Spreads of these rates over those on comparable-maturity Treasury securities remained at elevated levels.

Before the onset of the financial crisis, the market for ABS provided significant support for consumer lending by effectively reducing the cost to lenders of providing such credit. The near-complete cessation of issuance in this market in the fourth quarter of 2008 thus likely contributed importantly to the curtailment of consumer credit. Issuance of credit card, auto, and student loan ABS began to pick up in March and approached pre-crisis levels in April and May. Spreads of yields on AAA-rated credit card and auto ABS over yields on swaps fell sharply in early 2009, although they remained at somewhat elevated levels. The increased issuance and falling spreads appeared to reflect importantly the TALF program, which had been announced in late 2008 and began operation in March 2009. Availability of loans to purchase automobiles, which had declined sharply at the end of 2008, rebounded in early 2009 as some auto finance companies accessed credit through the TALF and others received funding directly from the government.

The Business Sector

Fixed Investment

Businesses have continued to cut back capital spending, with declines broadly based across equipment, software, and structures. Real business fixed investment fell markedly in the final quarter of 2008 and the first quarter of this year. The cutbacks in business investment were prompted by a deterioration late last year and early this year in the economic and financial conditions that influence capital expenditures: In particular, business output contracted steeply, corporate profits declined, and credit availability remained tight for many borrowers. More recently, it appears that the declines in capital spending may be abating, and financing conditions for businesses have improved somewhat.

Real business outlays for equipment and software dropped at an annual rate of 34 percent in the first quarter of 2009 after falling nearly as rapidly in the fourth quarter. In both quarters, business purchases of motor vehicles plunged at annual rates of roughly 80 percent, and real spending on high-tech capital—computers, software, and communications equipment—fell at an annual rate of more than 20 percent. Real investment in equipment other than high tech and transportation, which accounts for nearly one-half of outlays for equipment and software, dropped at an annual rate of about 35 percent in the first quarter after falling at a 20 percent rate in the previous quarter. The available indicators suggest that real spending on equipment and software fell further in the second quarter, though at a much less precipitous pace: Although shipments of nondefense capital goods other than transportation items continued to fall in

April and May, the rate of decline slowed from the first-quarter pace. In addition, business purchases of new trucks and cars appear to have stabilized in the second quarter (albeit at low levels), and recent surveys of business conditions have been generally less downbeat than earlier this year.

Real spending on nonresidential structures turned down late last year and fell sharply in the first quarter. Outlays for construction of commercial and office buildings declined appreciably late last year and have contracted further so far this year. Spending on drilling and mining structures, which had risen briskly for a number of years, has plunged this year in response to the substantial net decline in energy prices since last summer. In contrast, outlays on other energy-related projects—such as new power plants and the expansion and retooling of existing petroleum refineries—have been growing rapidly for some time now and continued to post robust gains through May. On balance, the recent data on construction expenditures suggest that declines in spending on nonresidential structures may have slowed in the second quarter. However, weak business output and profits, tight financing conditions, and rising vacancy rates likely will continue to weigh heavily on this sector.

Inventory Investment

Businesses ran off inventories aggressively in the first quarter, as firms entered the year with extremely high inventory-sales ratios despite having drawn down stocks throughout 2008. Much of the first-quarter liquidation occurred in the motor vehicle sector, where production was cut sharply and remained low in the second quarter. As a result, days' supply of domestic light vehicles dropped from its peak of about 100 days in February to less than 70 days at the end of June, closer to the automakers' preferred level.

Firms outside of the motor vehicle sector also have been making significant production adjustments to bring down inventories. Factory output (excluding motor vehicles and parts) plunged in the first quarter, and inventories of nonfarm goods other than motor vehicles were drawn down noticeably in real terms. According to the available data, this pattern of production declines and inventory liquidation appears to have continued in the second quarter as well. Although inventory-sales ratios remain elevated in many industries, some recent business surveys suggest that firms have become more comfortable in recent months with the current level of inventories.

Corporate Profits and Business Finance

Operating earnings per share for S&P 500 firms in the first quarter were about 35 percent below their year-earlier levels. Profitability of both financial and nonfinancial firms showed steep declines. Analysts' forecasts suggest that the pace of profit declines moderated only slightly in the second quarter, although downward revisions to forecasts for earnings over the next two years have slowed recently.

Business financial conditions in the first half of the year were characterized by lower demand for funds, even as financial conditions eased somewhat on balance. Borrowing by domestic nonfinancial businesses fell slightly in the first half of 2009 after having slowed markedly in the second half of 2008. The composition of borrowing shifted, with net issuance of corporate bonds surging, while both commercial and industrial (C&I) loans and CP outstanding fell. This reallocation of borrowing may have reflected a desire by businesses to strengthen their balance sheets by substituting longer-term sources of financing for shorter-term sources during a period when the cost of bond financing was generally falling. In particular, yields on both investment- and speculative-grade corporate bonds dropped sharply, and their spreads over yields on comparable-maturity Treasury securities narrowed appreciably, as investors' concerns about the economic outlook eased. Nonetheless, bond spreads remained somewhat elevated by historical standards.

C&I and commercial real estate (CRE) lending by commercial banks were both quite weak in the first half of 2009, likely reflecting reduced demand for loans and a tighter lending stance on the part of banks. The results of the April 2009 Senior Loan Officer Opinion Survey indicated that commercial banks had tightened terms and standards on C&I and CRE loans over the preceding three months. The market for commercial mortgage-backed securities (CMBS)—an important source of funding before the crisis—remained shut.

Both seasoned and initial equity offerings by nonfinancial corporations were modest over the first half of 2009. Equity retirements are estimated to have slowed in early 2009 from their rapid pace during the second half of 2008. As a result, net equity issuance in the first quarter declined by the smallest amount since 2002.

The credit quality of nonfinancial firms continued to deteriorate in the first half of 2009. The pace of rating downgrades on corporate bonds increased, and upgrades were relatively few. Delinquency rates on banks' C&I loans continued to increase in the first quarter, while those on CRE loans rose substantially. Delinquency rates on construction and land development loans for one- to four-family residential properties increased to more than 20 percent. Banks that responded to the Senior Loan Officer Opinion Survey conducted in April 2009 expected delinquency and charge-off rates on such loans to increase over the rest of 2009, assuming that economic activity progressed in line with consensus forecasts.

Financial firms issued bonds at a solid pace, including both debt issued under the Temporary Liquidity Guarantee Program of the Federal Deposit Insurance Corporation (FDIC) and debt issued without such guarantees. Equity issuance by such firms picked up substantially from a very low level following the completion of the SCAP reviews in May.

The Government Sector

Federal Government

The deficit in the federal unified budget has increased substantially during the current fiscal year. The budget costs associated with the Troubled Asset Relief Program (TARP), the conservatorship of the mortgage-related GSEs, and the fiscal stimulus package enacted in February, along with the effects of the weak economy on outlays and revenues, have all contributed to the widening of the budget gap. Over the first nine months of fiscal year 2009—from October through June—the unified budget recorded a deficit of about $1.1 trillion. The deficit is expected to widen further over the rest of the fiscal year because of the continued slow pace of economic activity, additional spending increases and tax cuts associated with the fiscal stimulus legislation, and further costs related to financial stabilization programs. The budget released by the Office of Management and Budget in May, which included the effects of the President's budget proposals, calculated that the deficit for fiscal 2009 would total more than $1.8 trillion (13 percent of nominal GDP), significantly larger than the deficit in fiscal 2008 of $459 billion (3¼ percent of nominal GDP).[4]

The decline in economic activity has cut deeply into tax receipts so far this fiscal year. After falling about 2 percent in fiscal 2008, federal receipts dropped about 18 percent in the first nine months of fiscal 2009 compared with the same period in fiscal 2008. The decline in revenue has been particularly pronounced for corporate receipts, which have plunged as corporate profits have contracted and as firms have presumably adjusted payments to take advantage of the bonus depreciation provisions contained in the Economic Stimulus Act of 2008 and the American Recovery and Reinvestment Act of 2009. Individual income and payroll tax receipts have also declined noticeably, reflecting the weakness in nominal personal income and reduced capital gains realizations.[5]

Nominal federal outlays have risen markedly of late. After having increased about 9 percent in fiscal 2008, outlays in the first nine months of fiscal 2009 were almost 21 percent higher than during the same period in fiscal 2008. Spending was boosted, in part, by $232 billion in outlays recorded for activities under the TARP and the conservatorship of the GSEs so far this fiscal year.[6] Spending for income support—particularly for unemployment insurance benefits—has been pushed up by the deterioration in labor market conditions as well as by policy decisions to expand funding for a number of benefit programs. Meanwhile, federal spending on defense, Medicare, and Social Security also has recorded sizable increases. In contrast, net interest payments declined compared with the same year-earlier period, as the reduction in interest rates on Treasury debt more than offset the rise in Treasury debt.

As measured in the national income and product accounts (NIPA), real federal expenditures on consumption and gross investment—the part of federal spending that is a direct component of GDP—fell at an annual rate of 4½ percent in the first quarter following its steep rise of more than 8 percent in 2008. Real defense spending more than accounted for the first-quarter contraction, as nondefense outlays increased slightly. However, in the second quarter, defense spending appears to have rebounded, and it is likely to rise further in coming quarters given currently enacted appropriations.

4. The President's budget includes a placeholder for additional funds for financial stabilization programs that have not been enacted but have an estimated budget cost of $250 billion.

5. While the 2009 stimulus plan has reduced individual taxes by around $13 billion so far in fiscal 2009, the stimulus tax rebates in 2008 lowered individual taxes by about $50 billion during the same period last year. Thus, the tax cuts associated with fiscal stimulus have not contributed to the year-over-year decline in individual tax receipts.

6. In the Monthly Treasury Statements and the Administration's budget, both equity purchases and debt-related transactions under the TARP are recorded on a net-present-value basis, taking into account market risk, and the Treasury's purchases of the GSE's MBS are recorded on a net-present-value basis. However, equity purchases from the GSEs in conservatorship are recorded on a cash-flow basis.

Federal Borrowing

Federal debt continued to increase in the first half of 2009, although at a slightly less rapid pace than had been posted in the second half of 2008. Despite the considerable issuance of Treasury securities in the first half of the year, demand at Treasury auctions generally kept pace, with bid-to-cover ratios within historical ranges. Foreign custody holdings of Treasury securities at the Federal Reserve Bank of New York grew steadily over the first half of the year. Fails-to-deliver of Treasury securities, which were elevated earlier in the year, generally decreased after the May 1 implementation of the Treasury Market Practices Group's recommendation of a mandatory charge for delivery failures.[7]

State and Local Government

The fiscal positions of state and local governments have deteriorated significantly over the past year, and budget strains are particularly acute in some states, as revenues have come in weaker than policymakers expected. At the state level, revenues from income, business, and sales taxes have declined sharply.[8] Plans by states to address widening projected budget gaps have included cutting planned spending, drawing down rainy day funds, and raising taxes and fees. In coming quarters, the grants-in-aid included in the fiscal stimulus legislation will likely mitigate somewhat the pressures on state budgets, but many states are still expecting significant budget gaps for the upcoming fiscal year. At the local level, revenues have held up fairly well; receipts from property taxes have continued to rise moderately, reflecting the typically slow response of property taxes to changes in home values.[9] Nevertheless, the sharp fall in house prices over the past two years is likely to put downward pressure on local revenues before long. Moreover, many state and local governments have experienced significant capital losses in their employee pension funds in the past year, and they will need to set aside money in coming years to rebuild pension assets.

Outlays by state and local governments have been restrained by the pressures on their budgets. As measured in the NIPA, aggregate real expenditures on consumption and gross investment

7. The fails charge is incurred when a party to a repurchase agreement or cash transaction fails to deliver the contracted Treasury security to the other party by the date agreed upon. The charge is a share of the value of the security, where the share is the greater of 3 percent (at an annual rate) minus the target federal funds rate (or the bottom of the range when the Federal Open Market Committee specifies a range) and zero. Previously, the practice was that a failed transaction was allowed to settle on a subsequent day at an unchanged invoice price; therefore, the cost of a fail was the lost interest on the funds owed in the transaction, which was minimal when short-term interest rates were very low. The new practice of a fails charge ensures that the total cost of a fail is at least 3 percent.

8. Sales taxes account for nearly one-half of the tax revenues collected by state governments.

9. The delay between changes in house prices and changes in property tax revenues likely occurs for three reasons. First, property taxes are based on assessed property values from the previous year. Second, in many jurisdictions, assessments are required to lag contemporaneous changes in market values (or they lag such changes for administrative reasons). Third, many localities are subject to state limits on the annual increases in total property tax payments and property value assessments. Thus, increases and decreases in market prices for houses tend not to be reflected in property tax bills for quite some time.

by state and local governments—the part of state and local spending that is a direct component of GDP—fell in both the fourth quarter of last year and the first quarter of this year, led by sharp declines in real construction spending. However, recent data on construction expenditures suggest that investment spending in the second quarter picked up, reversing a portion of the earlier declines. State and local employment has remained about flat over the past year, although some state and local governments are in the process of reducing outlays for compensation through wage freezes and mandatory furloughs that are not reflected in the employment figures.

State and Local Government Borrowing

On net, bond issuance by state and local governments picked up in the second quarter of 2009 after having been tepid during the first quarter. Issuance of short-term debt remained modest, although about in line with typical seasonal patterns. Issuance of long-term debt, which is generally used to fund capital spending projects or to refund existing long-term debt, increased from the sluggish pace seen in the second half of 2008. The composition of new issues continued to be skewed toward higher-rated borrowers.

Interest rates on long-term municipal bonds declined in April as investors' concerns about the credit quality of municipal bonds appeared to ease somewhat with the passage of the fiscal stimulus plan, which included a substantial increase in the amount of federal grants to states and localities. That bill also aided the finances of state and local governments by establishing Build America Bonds, taxable state and local government bonds whose interest payments are subsidized by the Treasury at a 35 percent rate. Yields on municipal securities rose somewhat in May and June, concomitant with the rise in other long-term interest rates over that period; even so, the ratio of municipal bond yields to those on comparable-maturity Treasury securities dropped to its lowest level in almost a year.

In contrast to long-term municipal bond markets, conditions in short-term municipal bond markets continued to exhibit substantial strains. Market participants continued to report that the cost of liquidity support and credit enhancement for variable-rate demand obligations (VRDOs)—bonds that combine long maturities with floating short-term interest rates—remained substantially higher than it had been a year earlier.[10] In addition, auctions of most remaining auction-rate securities failed. Some municipalities were able to issue new VRDOs, but many lower-rated issuers appeared to be either unwilling or unable to issue this type of debt at the prices that would be demanded of them. However, the seven-day Securities Industry and Financial Markets Association swap index, a measure of yields for high-grade VRDOs, declined to the lowest level on record, suggesting that the market was working well for higher-rated issuers.

10. VRDOs are taxable or tax-exempt bonds that combine long maturities with floating short-term interest rates that are reset on a weekly, monthly, or other periodic basis. VRDOs also have a contractual liquidity backstop, typically provided by a commercial or investment bank, that ensures that bondholders are able to redeem their investment at par plus accrued interest even if the securities cannot be successfully remarketed to other investors.

The External Sector

The demand for U.S. exports dropped sharply in the first quarter. However, U.S. demand for imports fell even more precipitously, softening the decline in real GDP.

Real exports of goods and services declined at an annual rate of 31 percent in the first quarter, exceeding even the 24 percent rate of decline in the fourth quarter of 2008. Exports in almost all major categories contracted, with exports of machinery, industrial supplies, automotive products, and services recording large decreases. (Exports of aircraft were the exception, with increases following the end of strike-related production disruptions in the fourth quarter.) All of our major trading partners reduced their demand for U.S. exports, with exports to Canada, Europe, and Mexico exhibiting especially significant declines. Data for April and May suggest that exports in the second quarter continued to fall, although more moderately, reflecting a slowing in the rate of contraction in foreign economic activity.

Real imports of goods and services fell at an annual rate of more than 36 percent in the first quarter. The drop in imports was widespread across U.S. trading partners, with large declines observed for imports from Canada, Europe, Japan, and Latin America. All major categories of imports fell, with imports of machinery, automotive products, and industrial supplies displaying particularly pronounced declines. The sharp fall in exports and imports of automotive products partly reflected cutbacks in North American production of motor vehicles, which relies heavily on flows of parts and finished vehicles among the United States, Canada, and Mexico.

In the first quarter of 2009, the U.S. current account deficit was $406 billion at an annual rate, a bit less than 3 percent of GDP, considerably narrower than the $706 billion deficit recorded in 2008. The narrowing largely reflected the sharp reduction in the U.S. trade deficit, with the contraction in real imports described earlier being compounded by a steep fall in the value of nominal oil imports as oil prices declined.

Import prices fell sharply in late 2008 and the first quarter of this year, but they have stabilized over the past few months. This pattern was influenced importantly by the swing in prices for oil and non-oil commodities, which turned back up in the second quarter. Prices for finished goods declined only slightly in the last quarter of 2008 and the first quarter of this year and have increased slightly in recent months.

The price of crude oil in world markets rose considerably over the first half of this year. After plunging from a record high of more than $145 per barrel in mid-July 2008 to a December average of about $40, the spot price of West Texas intermediate (WTI) crude oil rebounded to about $60 per barrel in mid-July of this year. The rebound in oil prices appears to reflect the view that the global demand for oil has begun to pick up once again. In addition, the ongoing effects of previous reductions in OPEC supply seem to be putting upward pressure on oil prices. The prices of longer-term futures contracts for crude oil have moved up to around $85 per barrel, reflecting the view that the market will continue to tighten as global demand strengthens over the medium term.

National Saving

Total net national saving—that is, the saving of households, businesses, and governments, excluding depreciation charges as measured in the NIPA—fell to a level of negative 1½ percent of nominal GDP in the first quarter of this year, its lowest reading in the post–World War II period. After having reached 3½ percent of nominal GDP in early 2006, net national saving dropped over the subsequent three years as the federal budget deficit widened substantially and the fiscal positions of state and local governments deteriorated. In contrast, private saving has risen considerably, on balance, over this period, as a decline in business saving has been more than offset by the recent jump in personal saving. National saving will likely remain very low this year in light of the weak economy and the probable further widening of the federal budget deficit. Nonetheless, if not boosted over the longer run, persistent low levels of national saving will likely be associated with both low rates of capital formation and heavy borrowing from abroad, which would limit the rise in the standard of living of U.S. residents over time and hamper the ability of the nation to meet the retirement needs of an aging population.

The Labor Market

Employment and Unemployment

The labor market deteriorated significantly further in the first half of this year as employment continued to fall and the unemployment rate rose sharply. The job losses so far this year have been widespread across industries and have brought the cumulative decline in private employment since December 2007 to more than 6½ million jobs. In recent months, however, the pace of job loss has moderated somewhat. Private nonfarm payroll employment fell by 670,000 jobs, on average, per month from January to April, but the declines slowed to 312,000 in May and 415,000 in June. In contrast, the civilian unemployment rate has continued to move up rapidly so far this year, climbing 2¼ percentage points between December 2008 and June to 9½ percent.

Virtually all major industries experienced considerable job losses in the first few months of the year. More recently, employment declines in many industry groups have eased, and some industries have reported small gains. The May and June declines in construction jobs were the smallest since last fall, job declines in temporary help services slowed noticeably, and employment in nonbusiness services turned up in May and increased further in June. Meanwhile, in the manufacturing sector, employment declines have subsided a bit in recent months but still remain sizable; job losses in this sector have totaled 1.9 million since the start of the recession.

In addition to shedding jobs, firms have cut their labor input by shortening hours worked. Average weekly hours of production and nonsupervisory workers on private payrolls dropped sharply through June. In addition, the share of persons who reported that they were working part time for economic reasons—a group that includes individuals whose hours have been cut by their employers as well as those who would like to move to full-time jobs but are unable to find them—is high.

Since the beginning of the recession in December 2007, the unemployment rate has risen more than 4½ percentage points. The rise in joblessness has been especially pronounced for those who lost their jobs permanently; these individuals tend to take longer to find new jobs than those on temporary layoffs or those who left their jobs voluntarily, and their difficulty in finding new jobs has been exacerbated by the ongoing weakness in hiring. Accordingly, the median duration of uncompleted spells of unemployment has increased from 8½ weeks in December 2007 to 18 weeks in June 2009, and the number of workers unemployed more than 15 weeks has moved up appreciably.

The labor force participation rate, which typically weakens during periods of rising unemployment, decreased gradually through March but has moved up somewhat, on balance, in recent months. The emergency unemployment insurance programs that were introduced last July have likely contributed to the higher participation rate and unemployment rate by encouraging unemployed individuals to remain in the labor force to continue to look for work. In addition, anecdotes suggest that the impairment of household balance sheets during this recession may have led some workers to delay retirement and other workers to enter the labor force.

Other more recent indicators suggest that conditions in the labor market remain very weak. Initial claims for unemployment insurance, which rose dramatically earlier this year, have fallen noticeably from their peak but remain elevated, and the number of individuals receiving regular and emergency unemployment insurance benefits climbed, reaching nearly 10 million at the end of June.

Productivity and Labor Compensation

Labor productivity has continued to increase at a surprising rate during the most recent downturn, in part because firms have responded to the contraction in aggregate demand by aggressively reducing employment and shortening the workweeks of their employees. According to the latest available published data, output per hour in the nonfarm business sector increased at an annual rate of about 1½ percent in the first quarter after rising 2¼ percent during all of 2008. If these productivity estimates prove to be accurate, they would suggest that the fundamental factors that have supported a solid trend in underlying productivity in recent years—such as the rapid pace of technological change and ongoing efforts by firms to use information technology to improve the efficiency of their operations—remain in place.

Alternative measures of nominal hourly compensation and wages suggest, on balance, that increases in labor costs have slowed this year in response to the sizable amount of slack in labor markets. The employment cost index (ECI) for private industry workers, which measures both wages and the cost to employers of providing benefits, has decelerated considerably over the past year. This measure of compensation increased less than 2 percent in nominal terms between March 2008 and March 2009 after rising 3¼ percent in each of the preceding two years. Average hourly earnings of production and nonsupervisory workers—a more timely, but narrower, measure of wage developments—have also decelerated significantly, especially in recent months. In contrast, compensation per hour (CPH) in the nonfarm business sector—an alternative measure of hourly compensation derived from the data in the NIPA—increased about 4 percent over the year ending in the first quarter of 2009, similar to the rate of increase seen during the past several years.

The much slower pace of overall consumer price inflation over the past year has supported real wage growth. Indeed, changes in both broad measures of hourly compensation—the ECI and CPH—have picked up in real terms over the past year, as has the inflation-adjusted increase in average hourly earnings. Nonetheless, as noted previously, with the sharp reduction in total hours worked, real wage and salary income of households has fallen over this period.

Prices

Headline consumer prices, which fell sharply late last year with the marked deterioration in economic activity and drop-off in the prices of crude oil and other commodities, have risen at a moderate pace so far this year. While the margin of slack in product and labor markets has widened considerably further this year, putting downward pressure on inflation, many commodity prices have retraced part of their earlier declines. All told, the chain-type price index for personal consumption expenditures increased at an annual rate of about 1¾ percent between December 2008 and May 2009, compared with its ¾ percent rise over the 12 months of 2008. The core PCE price index—which excludes the prices of energy items as well as those of food and beverages—also has increased at a moderate pace so far this year following especially low rates of increase late in 2008. Data for PCE prices in June are not yet available, but information from the consumer price index and other sources suggests that total PCE prices posted a relatively large increase that month as gasoline prices jumped; core consumer price increases were moderate.

Consumer energy prices flattened out, on balance, in the first five months of 2009 following their sharp drop late last year. However, crude oil prices have turned up again, with the spot price of WTI rising to around $60 per barrel in mid-July from about $40, on average, last December. The increase in crude costs has been putting upward pressure on the price of gasoline at the pump in recent months. In contrast, natural gas prices continued to plunge over the first half of this year in response to burgeoning supplies from new wells in Louisiana, North Dakota, Pennsylvania, and Texas that boosted inventories above historical midyear averages. Consumer prices for electricity have edged down so far this year—after rising briskly through the end of last year—as fossil fuel input costs have continued to decline.

Food prices decelerated considerably in the first part of this year in response to the dramatic downturn in spot prices of crops and livestock in the second half of last year. After climbing nearly 6½ percent in 2008, the PCE price index for food and beverages decreased at an annual rate of 1 percent between December 2008 and May 2009.

Core PCE prices rose at an annual rate of 2½ percent over the first five months of the year, compared with 1¾ percent over all of 2008. The pickup in core inflation during the first part of this year reflected, in part, a jump in the prices of tobacco products associated with large increases in federal and state excise taxes this spring; excluding tobacco prices—for which the large increases likely were one-off adjustments—core inflation was unchanged at 1¾ percent over this period. Aside from tobacco, prices for other core goods snapped back early this year—following heavy discounting at the end of last year in reaction to weak demand and excess inventories—but have been little changed for the most part in recent months. In contrast, prices for a wide range of non-energy services have decelerated noticeably further this year.

Survey-based measures of near-term inflation expectations declined late last year and early this year as actual headline inflation came down markedly, but, in recent months, some measures have moved back up close to their average levels of recent years. According to the Reuters/University of Michigan Surveys of Consumers, median expectations for year-ahead inflation stood at 3.0 percent in the preliminary estimate for July, up from about 2 percent around the turn of the year. Indicators of longer-term inflation expectations have been steadier over this period. These expectations in the Reuters/University of Michigan survey stood at 3.1 percent in the preliminary July release, about the measure's average value over all of 2008.

Financial Stability Developments

Evolution of the Financial Turmoil, Policy Actions, and the Market Response

Stresses in financial markets intensified in the first few months of 2009 but have eased more recently. Credit default swap spreads for bank holding companies—which primarily reflect investors' assessments of the likelihood of those institutions defaulting on their debt obligations—rose sharply in early January on renewed concerns that some of those firms could face considerable capital shortfalls and liquidity difficulties. Equity prices for banking and insurance companies fell in the first quarter of the year as a number of large financial institutions reported substantial losses for the fourth quarter of 2008.

Strains in short-term funding markets persisted in January and February. A measure of stress in the interbank market, the spread of the London interbank offered rate (Libor) over the rate on comparable-maturity overnight index swaps (OIS), remained at elevated levels early in the year. Required margins of collateral (also known as haircuts) and bid-asked spreads generally continued to be wide in the markets for repurchase agreements backed by many types of securities.

Other financial markets also continued to show signs of stress during the first two months of the year. In the leveraged loan market, bid prices remained close to historical lows, and issuance—particularly of loans intended for nonbank lenders—dropped to very low levels. Issuance of securities backed by credit card loans, nonrevolving consumer loans, and auto loans continued to be minimal in the first few months of the year, and there was no issuance of CMBS in the first half of 2009. An index based on CDS spreads on AAA-rated CMBS widened and neared the peak levels seen in November. Broad equity price indexes continued to fall, and measures of equity price volatility remained very high.

Nonetheless, a few financial markets showed signs of improvement early in the year. In the CP market, spreads on shorter-maturity A1/P1 nonfinancial and financial CP as well as on asset-backed commercial paper (ABCP) over AA nonfinancial CP declined modestly. Although part of the improvement likely reflected greater demand from institutional investors as short-term Treasury yields declined to near zero on occasion, CP markets continued to be supported by the Federal Reserve's Commercial Paper Funding Facility (CPFF). More notably, spreads on shorter-maturity A2/P2 CP, which is not eligible for purchase under the CPFF, also fell. In the corporate bond market, spreads of yields on BBB-rated and speculative-grade bonds relative to yields on comparable-maturity Treasury securities narrowed in January and February, although they remained at historically high levels. Spreads on 10-year Fannie Mae debt and option-adjusted spreads on Fannie Mae mortgage-backed securities over comparable-maturity Treasury securities dropped early in the year, reflecting, in part, the effects of Federal Reserve purchases of agency debt and agency MBS. Interest rates on 30-year fixed rate conforming mortgages also fell.

In an effort to help restore confidence in the strength of U.S. financial institutions and restart the flow of lending to businesses and households, on February 10, the Treasury, the Federal Reserve, the FDIC, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision announced the Financial Stability Plan. The plan included the Capital Assistance Program (CAP), designed to assess the capital needs of depository institutions under a range of economic scenarios and to help increase the amount and strengthen the quality of their capital if necessary; a new Public-Private Investment Program, or PPIP, which would combine public and private capital with government financing to help banks dispose of legacy assets and strengthen their balance sheets, thereby supporting new lending; an expansion of the Federal Reserve's TALF program; and an extension of the senior debt portion of the FDIC's Temporary Liquidity Guarantee Program to October 31, 2009.

The announcement of the plan did not lead to an immediate improvement in financial market conditions. Bank and insurance company equity prices continued to decline, and CDS spreads of such institutions widened to levels above those observed the previous fall. Market participants were reportedly unclear about the methodology that would underlie the assessment of bank capital needs. The timing of the announcement of the results and the likely policy responses from this part of the CAP—formally named the SCAP, but popularly known as the stress test—were also sources of uncertainty. (CAP and SCAP are described in greater detail in the box titled "Capital Assistance Program and Supervisory Capital Assessment Program.") On March 2, American International Group, Inc. (AIG), reported losses of more than $60 billion for the fourth quarter of 2008, and the Treasury and the Federal Reserve announced a restructuring of the government assistance to AIG to enhance the company's capital and liquidity in order to facilitate the orderly completion of its global divestiture program.

On March 3, the Treasury and the Federal Reserve announced the launch of the TALF. In the initial phase of the program, the Federal Reserve offered to provide up to $200 billion of three-year loans on a nonrecourse basis secured by AAA-rated ABS backed by newly and recently originated auto loans, credit card loans, student loans, and loans guaranteed by the Small Business Administration. The Treasury's TARP would purchase $20 billion of subordinated debt in a special purpose vehicle (SPV) created by the Federal Reserve Bank of New York. The SPV would purchase and manage any assets received by the New York Fed in connection with any TALF loans. The demand for TALF funding was initially

Capital Assistance Program and Supervisory Capital Assessment Program

On February 10, 2009, the Treasury, Federal Reserve, Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency, and Office of Thrift Supervision announced a Capital Assistance Program (CAP) to ensure that the largest banking institutions would be appropriately capitalized with high-quality capital. As part of this program, the federal banking supervisors undertook a Supervisory Capital Assessment Program (SCAP) to evaluate the capital needs of the largest U.S. bank holding companies (BHCs) under a more challenging economic environment than generally anticipated. The Treasury and federal banking agencies believe it important for the largest BHCs to have a capital buffer sufficient to withstand losses and allow them to meet the credit needs of their customers if the economy were to weaken more than expected in order to help facilitate a broad and sustainable economic recovery.

The SCAP was initiated on February 25, 2009, and results were released publicly on May 7, 2009. U.S. BHCs with risk-weighted assets of more than $100 billion at the end of 2008 were required to participate. The objective of the exercise was to conduct a comprehensive and consistent assessment simultaneously on the largest BHCs using a common set of alternative macroeconomic scenarios and a common forward-looking conceptual framework. Extensive information was collected on the characteristics of the major loan, securities, and trading portfolios, revenues, and modeling methods of the institutions. With this information, supervisors were able to apply a consistent and systematic approach across firms to estimate losses, revenues, and reserves for 2009 and 2010, and to determine whether firms would need to raise capital to build a buffer to withstand larger-than-expected losses. The SCAP buffer for each BHC was sized to achieve a Tier 1 risk-based ratio of 6 percent and a Tier 1 Common risk-based ratio of 4 percent at the end of 2010 under a more severe macroeconomic scenario than expected.

Supervisors took the unusual step of publicly reporting the findings of the SCAP. The decision to depart from the standard practice of maintaining confidentiality of examination information stemmed from the belief that greater

modest, reportedly on concerns that future changes in government policies could adversely affect TALF borrowers.

Financial markets began to show signs of improvement in early March when a few large banks indicated that they had been profitable in January and February. Sentiment continued to improve after the March 17-18 meeting of the Federal Open Market Committee (FOMC), at which, against a backdrop of weakening economic activity and significant financial market strains, the Committee announced that it would expand its purchases of agency MBS by $750 billion, and of agency debt by $100 billion; in addition it would also purchase up to $300 billion of longer-term Treasury securities over the next six months. Yields on a wide range of longer-term debt securities dropped substantially within a day of the release of the Committee's statement. First-quarter earnings results pre-announced by some large financial institutions were substantially better than expected, although some of the surprise was attributable to greater-than-anticipated clarity around the SCAP process and findings would make the exercise more effective at reducing uncertainty and restoring confidence in financial institutions.[1]

Results of the SCAP indicated that 10 firms would need to augment their capital or improve the quality of the capital from 2008:Q4 levels; the combined amount totaled $185 billion, nearly all of which is required to meet the target Tier 1 Common risk-based ratio. Between the end of 2008 and the release of the results in May, many firms had already completed or contracted for asset sales or restructured existing capital instruments. After adjusting for these transactions and revenues that exceeded what had been assumed in the SCAP, the combined amount of additional capital needed to establish the buffer was $75 billion. The 10 firms are required to raise the additional capital by November 9, 2009.

Since the release of the results, almost all of the 10 firms that were asked to raise capital buffers issued new common equity in the public markets and raised about $40 billion; they also raised a substantial additional amount of capital by exchanging preferred shares to common shares and selling assets. Firms that do not meet their buffer requirement can issue mandatory convertible shares to the Treasury in an amount up to 2 percent of the institution's risk-weighted assets (or higher on request), as a bridge to private capital. In addition, firms can apply to the Treasury to exchange their existing Capital Purchase Program preferred stock to help meet their buffer requirement. To protect taxpayers, firms will be expected to have issued private capital before or simultaneously with the exchange.

The firms not asked to augment their capital also raised about $20 billion in common equity in May and early June. Most of these firms and others applied for and received approval from their supervisors to repay their outstanding Capital Purchase Program preferred stock. In early June, 10 large BHCs repaid about $68 billion to the Treasury. A number of banks have also been able to issue debt not guaranteed by the FDIC's Temporary Liquidity Guarantee Program.

1. A description of the methodology and a summary of results, including loss rates on major loan categories for each firm, is available at www.federalreserve.gov/bankinforeg/scap.htm.

effects of revisions in accounting rules.[11] Equity prices of banks and insurance companies rose, and CDS spreads for such institutions narrowed, although to still-elevated levels. Broad stock price indexes also climbed and measures of equity price volatility declined. Libor-OIS spreads began to edge down. Spreads on lower-rated investment-grade and speculative-grade corporate bonds over comparable-maturity Treasury securities also fell, though again to levels that remained high by historical standards. Bid-asked

11. In early April, the Financial Accounting Standards Board issued new guidance related to fair value measurements and other-than-temporary impairments (OTTIs). The new fair value guidance reduces the emphasis to be placed on the "last transaction price" in valuing assets when markets are not active and transactions are likely to be forced or distressed. The new OTTI guidance will require impairment write-downs through earnings only for the credit-related portion of a debt security's fair value impairment when two criteria are met: (1) The institution does not have the intent to sell the debt security, and (2) it is unlikely that the institution will be required to sell the debt security before a forecasted recovery of its cost basis. The two changes have resulted in higher fair value estimates and reductions in impairments, improving institutions' reported first-quarter earnings.

spreads on speculative-grade bonds declined. Similarly, bid-asked spreads narrowed in the leveraged loan market.

Conditions in financial markets continued to improve in the second quarter, aided in part by the emergence of more detail on the SCAP program and the release of its results on May 7. Market participants reportedly viewed the amount of additional capital that banks were required to raise in conjunction with the SCAP as relatively modest. With uncertainty about the SCAP results resolved, and amid the ongoing improvements in financial markets, market participants appeared to mark down the probability of extremely adverse financial market outcomes. Equity prices for many large banks and insurance companies rose even as substantial equity issuance by banks covered by the SCAP program added to supply. The secondary market for leveraged loans also showed improvement, with the average bid price rising considerably; issuance, however, particularly of institutional loans, remained very weak. Short-term interbank funding markets continued to improve, with Libor-OIS spreads at one-month tenors declining to near precrisis levels; spreads at longer tenors also fell but remained very high. Demand for TALF funds increased in May and June, particularly for securities backed by credit card and auto loans. Supported by the TALF, issuance of consumer ABS picked up further in May, and it began to approach precrisis levels. Also in May, the Federal Reserve announced that, starting in June, CMBS and securities backed by insurance premium finance loans would be eligible collateral under the TALF. Financial markets abroad also improved during the second quarter, reflecting improved global economic prospects and positive news from the banking sector (see "International Developments" for additional detail).

In early June, the Federal Reserve outlined the criteria it would use to evaluate applications to redeem Treasury capital from participants in the SCAP. On June 17, 10 banking institutions redeemed about $68 billion in Treasury capital. At about the same time, the 10 banking organizations that had been required under the SCAP to bolster their capital buffers all submitted plans that would provide sufficient capital to meet the required buffer under the assessment's more adverse scenario. On June 25, the Federal Reserve announced that while it would extend a number of its liquidity facilities through early 2010, in light of the improvement in financial conditions and reduced usage of some of its facilities, it would trim their size and adjust some of their terms.

Banking Institutions

Profitability of the commercial banking sector, as measured by return on assets and return on equity, recovered somewhat in the first quarter after having posted near-record lows in the fourth quarter of 2008. Profits were concentrated at the largest banks and were driven by a rebound in trading revenue as well as reduced noninterest expense related to smaller write-downs of intangible assets. Smaller banks, in contrast, continued to lose money amid mounting credit losses. Indeed, at the industry level, loan quality deteriorated substantially from the already poor levels recorded late last year, with delinquency rates on credit card loans reaching their highest level on record (back to 1991). Delinquency rates on residential mortgages held by banks soared to 8 percent. Regulatory capital ratios improved in the fourth quarter of 2008 and the first quarter of 2009 as commercial banks received substantial capital infusions—likely related to funds received by their parent bank holding companies under the Capital Purchase Program—while total assets declined. Despite a decline in loans outstanding, unused commitments to fund loans to both households and businesses shrank at an annual rate of more than 30 percent in the first quarter of 2009.

Commercial bank lending contracted at an annual rate of nearly 7 percent during the first half of 2009, reflecting weak loan demand and tight credit conditions. C&I loans fell at an annual rate of about 14 percent over this period, partly as a result of broad and sustained paydowns of outstanding loans amid weak investment spending by businesses. Some of these paydowns also were likely related to increased issuance of longer-term corporate debt, as nonfinancial firms—especially those rated as investment grade—tapped the corporate bond market. CRE loans ran off steadily, likely a result of continued weakness in that sector. Bank loans to households also fell over the first half of the year, particularly in the spring, as banks reportedly sold or securitized large volumes of residential mortgages and consumer credit card loans. Loan loss reserves reported by large banks increased considerably in the second quarter, suggesting continued deterioration in credit quality and further pressure on earnings.

The Senior Loan Officer Opinion Survey conducted in April 2009 indicated that large fractions of banks continued to tighten standards and terms on loans to businesses and households over the preceding three months. For most loan categories, however, the fractions of banks that reported having done so decreased from the January survey. The majority of respondents to the April survey indicated that they expected the credit quality of their loan portfolios to worsen over the remainder of the year. Demand for most types of loans also reportedly weakened over the survey period, with the noticeable exception of demand from prime borrowers for mortgages to purchase homes—a development that coincided with a temporary rise in applications to refinance home mortgages.

Data from the February and May Surveys of Terms of Business Lending indicated that the spreads of yields on C&I loans over those on comparable-maturity market instruments rose noticeably. The increase in the May survey was partly attributable to a steep increase in spreads on loans made under commitment, as a larger share of loans in the May survey were drawn from commitments arranged after the onset of the financial crisis.

Monetary Policy Expectations and Treasury Rates

The current target range for the federal funds rate, 0 to ¼ percent, is in line with the level that investors expected at the end of 2008. However, over the first half of 2009, investors marked down, on balance, their expectation for the path of the federal funds rate for the remainder of the year. Early in the year, the markdown was attributable to continued concerns about the health of financial institutions, weakness in the real economy, and a moderation in inflation pressures. Later in the period, FOMC communications indicating that the federal funds rate would likely remain low for an extended period reportedly also contributed to the downward revision to policy expectations. In contrast, investors marked up their expectations about the pace with which policy accommodation will be removed in 2010, likely in light of increased optimism about the economic outlook. Futures quotes currently suggest that investors expect the federal funds rate to remain within the current target range for the remainder of this year and then to rise in 2010. However, uncertainty about the size of term premiums and potential distortions created by the zero lower bound for the federal funds rate continue to make it difficult to obtain a definitive reading on the policy expectations of market participants from futures prices. Options prices suggest that investor uncertainty about the future path for policy increased, on balance, during the first half of 2009.

Yields on longer-maturity Treasury securities increased substantially, on net, over the first half of 2009, in response to better-than-expected economic data releases, declines in the weight investors attached to highly adverse economic outcomes, signs of thawing in the credit markets, technical factors related to the hedging of mortgage holdings, and the large increase in the expected supply of such securities. The rise in Treasury yields has likely been mitigated somewhat by the implementation of the Federal Reserve's large-scale asset purchases, under which the Federal Reserve is conducting substantial purchases of agency debt, agency MBS, and longer-maturity Treasury securities. On net, yields on 2- and 10-year Treasury notes rose about 50 and 115 basis points, respectively, during the first half of 2009, with the rise concentrated in the second quarter, after having declined about 200 and 140 basis points, respectively, during the second half of 2008.

In contrast to yields on their nominal counterparts, yields on Treasury inflation-protected securities (TIPS) declined over the first half of 2009, which resulted in a noticeable increase in measured inflation compensation—the difference between comparable-maturity nominal yields and TIPS yields. Inferences about inflation expectations from inflation compensation have been difficult to make since the second half of 2008 because yields on nominal and TIPS issues appear to have been affected significantly by movements in liquidity premiums, and because other special factors have buffeted yields on nominal Treasury issues. Some of these special factors have begun to subside in recent months, suggesting that the increase in inflation compensation since year-end is partly due to an improvement in market functioning and other special factors, although near-term inflation expectations may have been boosted by rising energy prices.

Monetary Aggregates and the Federal Reserve's Balance Sheet

The M2 monetary aggregate expanded at an annual rate of 7¾ percent during the first half of 2009, reflecting robust growth in the first quarter and more moderate growth in the second.[12] This

12. M2 consists of (1) currency outside the U.S. Treasury, Federal Reserve Banks, and the vaults of depository institutions; (2) traveler's checks of nonbank issuers; (3) demand deposits at commercial banks (excluding those amounts held by depository institutions, the U.S. government, and foreign banks and official institutions) less cash items in the process of collection and Federal Reserve float; (4) other checkable deposits (negotiable order of withdrawal, or NOW, accounts and automatic transfer service accounts at depository institutions; credit union share draft accounts; and demand deposits at thrift institutions); (5) savings deposits (including money market deposit accounts); (6) small-denomination time deposits (time deposits issued in amounts of less than $100,000) less individual retirement account (IRA) and Keogh balances at depository institutions; and (7) balances in retail money

expansion was due in part to the relatively small difference between market interest rates and the rates offered on M2 assets, as well as an increased desire of households and firms to hold safe and liquid assets because of the financial turmoil. Strong growth in liquid deposits was partially offset by rapid declines in small time deposits and retail money market mutual funds, as yields on the latter two assets dropped relative to rates on liquid deposits. The currency component of the money stock also increased, with a notable rise in the first quarter that appeared to reflect strong demand for U.S. banknotes from both foreign and domestic sources. The monetary base—essentially the sum of currency in the hands of the public and the reserve balances of depository institutions held at the Federal Reserve—continued to expand rapidly in the first quarter of 2009, albeit at a slower pace than in the second half of 2008. The expansion of the monetary base slowed further in the second quarter of 2009, as a decline in amounts outstanding under the Federal Reserve's credit and liquidity programs partially offset the effects on reserve balances of the Federal Reserve's large-scale asset purchases.

The nontraditional monetary policy actions employed by the Federal Reserve since the onset of the current episode of financial turmoil have resulted in a considerable expansion of the Federal Reserve's balance sheet (table 1). On December 31, 2007, prior to much of the financial market turmoil, the Federal Reserve's assets totaled nearly $920 billion, the bulk of which was Treasury securities. Its liabilities included nearly $800 billion in Federal Reserve notes (currency in circulation) and about $20 billion in reserve balances held by depository institutions.

By December 31, 2008, after the introduction of several new Federal Reserve policy initiatives, assets had more than doubled to about $2.2 trillion. Holdings of U.S. Treasury securities had declined by nearly one-half. At that point, the majority of Federal Reserve assets consisted of credit extended to depository institutions, other central banks, and primary dealers.[13] The Federal Reserve had extended about $330 billion in funding to the CPFF and was providing more than $100 billion in support of certain critical institutions. The growth in assets was largely funded by an increase in reserve balances, which, at $860 billion, slightly exceeded currency in circulation.

Over the first half of this year, total Federal Reserve assets decreased slightly, on net, to about $2.1 trillion, though there were large changes in the composition of those assets. Holdings of Treasury securities increased to nearly $685 billion, and holdings of agency debt and MBS rose to more than $625 billion as a result of large-scale asset purchases. Credit extended to depository institutions, primary dealers, and other market participants fell as market functioning improved. The decline importantly reflected a decrease in foreign central banks' draws on dollar liquidity swap lines and a runoff in credit extended through the CPFF and the Term Auction Facility (TAF). The amount of credit extended in support of certain critical institutions remained about unchanged. On the liability side,

market mutual funds less IRA and Keogh balances at money market mutual funds.

13. Primary dealers are broker-dealers that trade in U.S. government securities with the Federal Reserve Bank of New York.

1. Selected Components of the Federal Reserve Balance Sheet, 2007–09

Millions of dollars

Balance sheet item	Dec. 31, 2007	Dec. 31, 2008	July 15, 2009
Total assets	**917,922**	**2,240,946**	**2,074,822**
Selected assets			
Credit extended to depository institutions and dealers			
Primary credit	8,620	93,769	34,743
Term auction credit	40,000	450,219	273,691
Central bank liquidity swaps	24,000	553,728	111,641
Primary Dealer Credit Facility and other broker-dealer credit	...	37,404	0
Credit extended to other market participants			
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility	...	23,765	5,469
Net portfolio holdings of Commercial Paper Funding Facility LLC	...	334,102	111,053
Net portfolio holdings of LLCs funded through the Money Market Investor Funding Facility	...	0	0
Term Asset-Backed Securities Loan Facility	...	...	30,121
Support of critical institutions			
Net portfolio holdings of Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC[1]	...	73,925	60,546
Credit extended to American International Group, Inc.	...	38,914	42,871
Securities held outright			
U.S. Treasury securities	740,611	475,921	684,030
Agency debt securities	0	19,708	101,701
Agency mortgage-backed securities (MBS)[2]	...	...	526,418
Memo			
Term Securities Lending Facility[3]	...	171,600	4,250
Total liabilities	**881,023**	**2,198,794**	**2,025,348**
Selected liabilities			
Federal Reserve notes in circulation	791,691	853,168	870,327
Reserve balances of depository institutions	20,767	860,000	808,824
U.S. Treasury, general account	16,120	106,123	65,234
U.S. Treasury, supplemental financing account	...	259,325	199,939
Total capital	**36,899**	**42,152**	**49,474**

Note: LLC is a limited liability company.

1. The Federal Reserve has extended credit to several LLCs in conjunction with efforts to support critical institutions. Maiden Lane LLC was formed to acquire certain assets of The Bear Stearns Companies, Inc. Maiden Lane II LLC was formed to purchase residential mortgage-backed securities from the U.S. securities lending reinvestment portfolio of subsidiaries of American International Group, Inc. (AIG). Maiden Lane III LLC was formed to purchase multisector collateralized debt obligations on which the Financial Products group of AIG has written credit default swap contracts.

2. Includes only MBS purchases that have already settled.

3. The Federal Reserve retains ownership of securities lent through the Term Securities Lending Facility.

. . . Not applicable.

Source: Federal Reserve Board.

reserve balances fell somewhat, while currency in circulation rose.

International Developments

International Financial Markets

During most of the first quarter of 2009, fears that global economic activity would spiral further downward led to a sharp selloff in foreign equity markets and to rising spreads on foreign corporate debt. Stock indexes in Europe and Japan fell about 20 percent, and European bank shares fell more than 40 percent in response to weak earnings reports and rising fears about the exposure of many Western European banks to emerging Europe. Interbank funding markets were supported by government guarantees of bank debt and other policies put in place during 2008 to aid wholesale funding. These markets remained more stressed than before the financial crisis, but their functioning continued to gradually improve from the serious disarray that occurred last fall.

Rapidly easing monetary policies in many foreign economies, along with further safe-haven flows into Treasury securities, fueled continued dollar appreciation over the first two months of the year. The Federal Reserve's broadest measure of the nominal trade-weighted foreign exchange value of the dollar rose more than 6 percent during January and February. However, beginning in March, the dollar depreciated as the global outlook improved a bit and investors accordingly shifted away from Treasury securities to riskier assets abroad, reversing the pattern observed in the fourth quarter of 2008. During the spring, the dollar fell most sharply against currencies of major commodity-producing economies such as Australia and Canada, as the improvement in the global outlook also boosted commodity prices. On net, the Federal Reserve's broad measure of the nominal exchange value of the dollar is about 2 percent lower than it was at the start of the year but remains well above its mid-2008 lows.

Stock markets around the world rebounded in the second quarter along with prospects for global growth. Financial stocks led this rise in the advanced foreign economies as some large banks reported strong earnings growth, which benefited from the low interest rate environment. On net, headline European stock indexes are now about where they were at the start of the year. Equity prices in the emerging market economies, which were helped both by the improved outlook and by an increased willingness on the part of investors to hold riskier assets, are now 20 to 75 percent higher than at the start of the year.

The decisions of several foreign central banks to engage in nontraditional monetary policies appeared to have some effect on longer-term interest rates. Yields on long-term British gilts fell 60 basis points around the March 5 announcement by the Bank of England that it would begin purchasing government securities, and yields on European covered bonds fell nearly 30 basis points over the week following the May 7 announcement by the European Central Bank (ECB) that it would purchase covered bonds. However, as the economic outlook improved some in the second quarter, and amid concerns about mounting fiscal deficits and debts, yields on nominal benchmark bonds rose. On balance, nominal benchmark bond yields in major foreign countries are higher than at the start of the year, even as yields on inflation-protected bonds have fallen.

The Financial Account

The pattern of financial flows between the United States and the rest of the world was strongly affected by the intensification of financial turmoil in the fall of 2008 and, more recently, by the easing of strains in financial markets. In the second half of 2008, U.S. investors withdrew to some extent from foreign securities, and foreigners slowed their purchases of U.S. assets. At the same time, foreigners noticeably shifted their purchases away from U.S. corporate and agency securities and toward safer U.S. Treasury securities. For 2008 as a whole, the size of the purchases of U.S. Treasury securities by foreigners was unprecedented, nearly doubling the previous record.

The pattern of flows has normalized somewhat this year. The pace of private foreign net Treasury purchases slowed in the first quarter, and in April flows turned to net sales, primarily of short-term Treasury securities, signaling some reversal of the flight to safety. Foreign demand for most other U.S. securities, however, remained extremely weak throughout the first part of 2009. Foreigners continued to sell U.S. corporate and agency securities through April, although they did show renewed interest in U.S. corporate stocks in March, April, and particularly May.

Foreign official institutions resumed strong net purchases of U.S. assets in the first several months of 2009, although acquisitions remained centered on U.S. Treasury securities. This development followed net sales in the fourth quarter of 2008 as some countries sold reserves to support their currencies; although foreign official institutions made large net purchases of Treasury securities, they sold larger amounts of other U.S. assets. Foreign official acquisitions of Treasury securities were concentrated in short-term bills for some months during the winter, but official acquisitions of long-term notes and bonds have been similar to those of bills over the period since February.

Resumption of portfolio investment abroad by U.S. investors in 2009 also pointed to reduced risk aversion in financial markets. Following unprecedented net inflows in this category in 2008 resulting from U.S. residents bringing home their foreign investments, outflows resumed in early 2009 as U.S. investors returned to net purchases of foreign securities. Finally, starting this year, improvements in the tone of interbank funding markets led to a resumption of net lending abroad by U.S. banks after a sharp contraction of lending in the fourth quarter. As private sources of dollar liquidity re-emerged, foreign banks were able to repay the loans they had received from their central banks. These foreign central banks, in turn, reduced the outstanding amounts of U.S. dollars drawn on swap lines from the Federal Reserve.

Advanced Foreign Economies

The contraction of economic activity in the major advanced foreign economies deepened in the first quarter, as financial turbulence, shrinking world trade, adverse wealth effects, and eroding business and consumer confidence continued to weigh on activity. GDP fell particularly sharply in Germany and Japan, which were hit hard by a contraction in manufacturing exports. Domestic demand plummeted across the advanced foreign economies, with double-digit declines in investment spending and sizable negative contributions of inventories to economic growth. Housing markets also continued to weaken in the first quarter, with prices and building activity declining. By the second quarter, however, monthly indicators of economic activity in these economies began to show some moderation in the pace of contraction. Purchasing managers indexes and surveys of business confidence rebounded in the second quarter from the exceptionally low levels reached in the first quarter, while industrial production stabilized somewhat.

Twelve-month consumer price inflation continued to decline during the first half of the year, driven down by the fall in oil and other commodity prices since mid-2008 and the significant increase in economic slack. Headline inflation fell to near or below zero in all major economies except the United Kingdom, where the depreciation of the pound late last year contributed to keeping inflation around 2 percent. Excluding food and energy prices, the slowing in consumer prices in these economies was more limited.

Foreign central banks responded to worsening economic conditions and reduced inflation by aggressively cutting policy rates and, in some cases, initiating unconventional monetary easing. The ECB and Bank of England each reduced its key policy rate 150 basis points over the first half of 2009, while the Bank of Canada lowered its rate 125 basis points. The Bank of Japan, which had already cut the overnight uncollateralized call rate to 10 basis points, kept rates at that minimal level. As policy rates fell to very low levels, central banks implemented nontraditional policies to provide further support to activity. The Bank of England established an Asset Purchase Facility to purchase up to £125 billion in government and corporate debt; the Bank of Japan announced that it would increase its purchase of Japanese government bonds, including longer-term bonds, and would purchase commercial paper outright; and the ECB announced plans to purchase as much as €60 billion in covered bonds over the next year and conducted its first one-year financing operations on June 24, allocating €442 billion.

Emerging Market Economies

The global financial crisis took its toll on the emerging market economies as well. After falling steeply in the fourth quarter, economic activity contracted sharply again in the first quarter. However, recent data on business sentiment, production, and retail sales suggest that economic activity may be starting to recover.

Among the larger developing economies, only China and India have maintained positive growth during the global slowdown. Chinese growth was supported in the first quarter and boosted significantly further in the second quarter by a large fiscal stimulus package, which focused on infrastructure investment, and by an enormous jump in credit growth. India's economy also was supported by fiscal stimulus and was relatively insulated from the negative global shock because it is less open. Elsewhere in emerging Asia, the economies of Hong Kong, Malaysia, Singapore, South Korea, Taiwan, and Thailand all contracted at double-digit annual rates in at least one quarter, in line with their deep trade and financial linkages with the global economy. More recently, however, indicators such as industrial production have turned up in some of these countries. In addition, exports, although they remain weak, have edged higher in some countries, partly because of stimulus-driven demand from China.

Economic activity in Mexico contracted sharply late last year and again in the first quarter, owing largely to Mexico's strong ties to the United States. The outbreak of the H1N1 virus was a significant drag on Mexican economic activity in the second quarter. In addition, the economies of Mexico and some other Latin American countries continued to be negatively affected by the sharp fall in commodity prices in the second half of last year. However, as in Asia, industrial production in several Latin American countries has recently turned higher. In Brazil, the automobile sector, which has received government support, appears to have led a rebound in output.

Several countries in emerging Europe continued to experience intense financial stress and sharp economic contractions in the first quarter, with activity declining at an especially precipitous rate in Latvia. The region has faced external financing difficulties as a result of large external imbalances and high dependence on foreign capital flows. Hungary, Latvia, Romania, and Ukraine are among the countries that have received official assistance from the International Monetary Fund.

As the global economy has slowed, inflation in emerging market economies has diminished. Inflation in emerging Asia has decreased significantly, especially in China where consumer prices in June were below their year-earlier levels. Reduced price pressures and weak economic growth prompted significant monetary easing in several Asian emerging market economies. Inflation in Latin America has fallen less sharply. Notably, Mexican inflation remains near its recent high, due in part to pass-through from the peso's depreciation earlier this year. In these circumstances, monetary easing has taken place in Latin America, but nominal interest rates remain somewhat higher than in Asia. Many emerging market economies have undertaken fiscal stimulus this year, although the degree has varied and all stimulus packages have been smaller than that in China.

Part 3 Monetary Policy: Recent Developments and Outlook

Monetary Policy over the First Half of 2009

Over the second half of 2008, the Federal Open Market Committee (FOMC) eased the stance of monetary policy by decreasing its target for the federal funds rate from 2 percent to a range between 0 and ¼ percent and took a number of additional actions to increase liquidity and improve the functioning of financial markets. During the first half of 2009, the FOMC maintained its target range for the federal funds rate of 0 to ¼ percent, and it extended and modified the nontraditional policy actions taken previously.

The data reviewed at the January 27–28 FOMC meeting indicated a continued sharp contraction in economic activity. The housing market remained on a steep downward trajectory, consumer spending continued its significant decline, the slowdown in business equipment investment intensified, and foreign demand had weakened. Conditions in the labor market had continued to deteriorate rapidly, and the drop in industrial production had accelerated. Headline consumer prices fell in November and December, reflecting declines in consumer energy prices; core consumer prices were about flat in those months. Although credit conditions generally had remained tight, some financial markets—particularly those that were receiving support from Federal Reserve liquidity facilities and other government actions—exhibited modest signs of improvement. Meeting participants—Federal Reserve Board governors and Federal Reserve Bank presidents—anticipated that a gradual recovery in U.S. economic activity would begin in the second half of the year in response to monetary easing, additional fiscal stimulus, relatively low energy prices, and continued efforts by the government to stabilize the financial sector and increase the availability of credit. Committee members agreed that keeping the target range for the federal funds rate at 0 to ¼ percent would be appropriate. In its January statement, the FOMC reiterated that the Federal Reserve would use all available tools to promote the resumption of sustainable economic growth and to preserve price stability. The Committee also stated that, in addition to the purchases of agency debt and mortgage-backed securities (MBS) already under way, it was prepared to purchase longer-term Treasury securities if evolving circumstances indicated that such transactions would be particularly effective in improving conditions in private credit markets. The Committee indicated that it would continue to monitor carefully the size and composition of the Federal Reserve's balance sheet in light of evolving financial market developments. It would also continue to assess whether expansions of, or modifications to, lending facilities would serve to further support credit markets and economic activity and help preserve price stability.

On February 7, 2009, the Committee met by conference call in a joint session with the Board of Governors to discuss the potential role of the Federal Reserve in the Treasury's forthcoming Financial Stability Plan. The Federal Reserve's primary direct role in the plan would be through an expansion of the previously announced Term Asset-Backed Securities Loan Facility (TALF), which would be supported by additional funds from the Treasury's Troubled Asset Relief Program (TARP). It was anticipated that such an expansion would provide additional assistance to financial markets and institutions in meeting the credit needs of households and businesses and thus would support overall economic activity.

At the March FOMC meeting, nearly all participants indicated that economic conditions had deteriorated relative to their expectations at the time of the January meeting. Economic activity continued to fall sharply, with widespread declines in payroll employment and industrial production. Consumer spending had remained flat at a low level, the housing market weakened further, and nonresidential construction fell. Business spending on equipment and software had continued to decline across a broad range of categories. Despite the cutbacks in production, inventory overhangs appeared to have worsened in a number of areas. Of particular note was the sharp fall in foreign economic activity, which was having a negative effect on U.S. exports. Both headline and core consumer prices had edged up in January and February. Credit conditions remained very tight, and financial markets continued to be fragile and unsettled, with pressures on financial institutions generally having intensified over the past few months. Overall, participants expressed concern about downside risks to an outlook for activity that was already weak. Nonetheless, looking beyond the very near term, participants saw a number of market forces and policies then in place as eventually leading to economic recovery. Notably, the low level of mortgage interest rates, reduced house prices, and the Administration's new programs to encourage mortgage refinancing and mitigate foreclosures ultimately could bring about a lower cost of homeownership, a sustained increase in home sales, and a stabilization of house prices.

In light of the deterioration in the economic situation and outlook, Committee members agreed that substantial additional purchases of longer-term assets would be appropriate. In its March statement, the Committee announced that, to provide greater support to mortgage lending and housing markets, it would increase the size of the Federal Reserve's balance sheet further by purchasing up to an additional $750 billion of agency MBS, bringing its total purchases of these securities up to $1.25 trillion in 2009, and that it would increase its purchases of agency debt this year by up to $100 billion to a total of up to $200 billion. Moreover, to help improve conditions in private credit markets, the Committee decided to purchase up to $300 billion of longer-term Treasury securities over the next six months. The Committee decided to maintain the target range for the federal funds rate at 0 to ¼ percent and noted in its March statement that it anticipated that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period. The Committee also noted that the Federal Reserve had launched the TALF to facilitate the extension of credit to households and small businesses, and it anticipated that the range of eligible collateral for this facility was likely to be expanded to include other financial assets. The Committee stated that it would continue to carefully monitor the size and composition of the Federal Reserve's balance sheet in light of evolving financial and economic developments.

On March 23, the Federal Reserve and the Treasury issued a joint statement on the role of the Federal Reserve in preserving financial and monetary stability. In the statement, the Federal Reserve and the Treasury agreed to continue to cooperate on measures to improve the stability and functioning of the financial system while minimizing the associated credit risk to the Federal Reserve and preserving the ability of the Federal Reserve to achieve its monetary policy objectives. The two government entities also agreed to work together with the Congress on a comprehensive resolution regime for systemically important financial institutions, and the Treasury promised to remove the emergency loans for systemically important institutions from the Federal Reserve's balance sheet over time to the extent its authorities permit.

At the FOMC meeting on April 28 and 29, participants noted that the pace of decline in some components of final demand appeared to have slowed. Consumer spending firmed in the first quarter after dropping markedly during the second half of 2008. Housing activity remained depressed but seemed to have leveled off in February and March. In contrast, businesses had cut production and employment substantially in recent months—reflecting, in part, inventory overhangs that had persisted into the early part of the year—and fixed investment continued to contract. Headline and core consumer prices rose at a moderate pace over the first three months of the year. Participants noted that financial market conditions had generally strengthened, and surveys and anecdotal reports pointed to a pickup in household and business confidence, which nonetheless remained at very low levels. Yields on Treasury and agency securities had fallen after the release of the March FOMC statement, which noted the increase in planned purchases of longer-term securities. However, this initial drop was subsequently reversed amid the improved economic outlook, an easing of concerns about financial institutions, and perhaps some unwinding of flight-to-quality flows. Participants anticipated that the acceleration in final demand and economic activity over the next few quarters would be modest, with growth of consumption expenditures likely to be restrained and business investment spending probably shrinking further. Looking further ahead, participants considered a number of factors that would be likely to restrain the pace of economic recovery over the medium term. Strains in credit markets were expected to recede only gradually as financial institutions continued to rebuild their capital and remained cautious in their approach to asset-liability management, especially given that the outlook for credit performance would probably remain weak. Households would likely continue to be cautious, and their desired saving rates would be relatively high over the extended period that would be required to bring their wealth back up to more normal levels relative to income. The stimulus from fiscal policy was expected to diminish over time as the government budget moved to a sustainable path. Demand for U.S. exports would also take time to revive, reflecting the gradual recovery of economic activity in our major trading partners.

Against this backdrop, the FOMC indicated that it would maintain the target range for the federal funds rate at 0 to ¼ percent and anticipated that economic conditions would be likely to warrant exceptionally low levels of the federal funds rate for an extended period. The Committee reiterated that, to provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve would purchase a total of up to $1.25 trillion of agency MBS and up to $200 billion of agency debt by the end of the year. In addition, the Federal Reserve would buy up to $300 billion of Treasury securities by autumn. The Committee would continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. The Federal Reserve was facilitating the extension of credit to households and businesses and supporting the functioning of financial markets through a range of liquidity programs. The Committee indicated that it would continue to carefully monitor the size and composition of the Federal Reserve's balance sheet in light of financial and economic developments.

The information reviewed at the June 23–24 FOMC meeting suggested that the economy remained weak, though declines in activity seemed to be lessening. Consumer spending appeared to have stabilized, sales and starts of new homes flattened out, and the recent declines in capital spending did not look as severe as those that had occurred around the turn of the year. At the same time, labor markets and industrial production continued to deteriorate sharply. Apart from a tax-induced jump in tobacco prices, consumer price inflation was fairly quiescent in recent months, although an upturn in energy prices appeared likely to boost headline inflation in June. Conditions and sentiment in financial markets had continued to show signs of improvement since the last meeting. The results of the Supervisory Capital Assessment Program (SCAP) were positively received by financial markets, credit default swap spreads of banking organizations declined considerably, and the institutions involved in the SCAP were subsequently able to issue significant amounts of public equity and nonguaranteed debt. The functioning of short-term funding markets improved, broad stock price indexes increased, and spreads on corporate bonds continued to narrow. Nominal Treasury yields climbed steeply, reflecting investors' perceptions of an improved economic outlook, a reversal of flight-to-quality

2. Extensions and Modifications of Federal Reserve Liquidity Programs

Liquidity program	Extension	Modification
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF)	Extended to February 1, 2010	Money market mutual funds have to experience material outflows before being able to sell asset-backed commercial paper that would be eligible collateral for AMLF loans.
Central bank swap lines	Extended to February 1, 2010	. . .
Commercial Paper Funding Facility	Extended to February 1, 2010	. . .
Money Market Investor Funding Facility	Expiration date remains at October 30, 2009	. . .
Primary Dealer Credit Facility	Extended to February 1, 2010	. . .
Term Asset-Backed Securities Loan Facility	Expiration date remains at December 31, 2009	. . .
Term Auction Facility	No fixed expiration date	Auction amounts reduced initially to $125 billion.
Term Securities Lending Facility	Extended to February 1, 2010	Auctions backed by Schedule 1 collateral suspended effective July 1, 2009. Auctions backed by Schedule 2 collateral now conducted every four weeks. Total amount offered reduced initially to $75 billion.

. . . Not applicable.
Source: Federal Reserve Board.

flows, and technical factors related to the hedging of mortgage holdings.

In its June statement, the FOMC reiterated that it would employ all available tools to promote economic recovery and preserve price stability. It noted that it would maintain its target range for the federal funds rate at 0 to ¼ percent and continued to anticipate that economic conditions would likely warrant exceptionally low levels of the federal funds rate for an extended period. The FOMC indicated that, as it had previously announced, to provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve would purchase a total of up to $1.25 trillion of agency MBS and up to $200 billion of agency debt by the end of the year. In addition, the Federal Reserve would buy up to $300 billion of Treasury securities by autumn. The Committee noted that it would continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. The FOMC also stated that the Federal Reserve was monitoring the size and composition of its balance sheet and would make adjustments to its credit and liquidity programs as warranted.

Conditions in financial markets had improved notably by the end of June, although market functioning in many areas remained impaired and seemed likely to remain strained for some time. Usage of some of the Federal Reserve's liquidity programs had also decreased in recent months. Against this backdrop, on June 25, the Federal Reserve announced extensions of and modifications to a number of its liquidity programs (see table 2 for a summary of the changes).[14] The Federal Reserve noted that the Board and the

14. For more details, see Board of Governors of the Federal Reserve System (2009), "Federal Reserve Announces Extensions of and Modifica-

FOMC would 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 anticipated that a number of the facilities might not need to be extended beyond February 1, 2010. However, if financial stresses did not moderate as expected, the Board and the FOMC were prepared to extend the terms of some or all of the facilities as needed to promote financial stability and economic growth. The public would receive timely notice of planned extensions, discontinuations, or modifications of Federal Reserve programs. The next section of this report, "Monetary Policy as the Economy Recovers," has further discussion related to the evolution of these programs.

Over the first half of the year, the Federal Reserve also undertook a number of initiatives to improve communications about its policy actions. These initiatives are described more fully in the box titled "Federal Reserve Initiatives to Increase Transparency."

Monetary Policy as the Economy Recovers

At present, the focus of monetary policy is on stimulating economic activity in order to limit the degree to which the economy falls short of full employment and to prevent a sustained decline in inflation below levels consistent with the Federal Reserve's legislated objectives. Economic conditions are likely to warrant accommodative monetary policy for an extended period. At some point, however, economic recovery will take hold, labor market conditions will improve, and the downward pressures on inflation will diminish. When this process has advanced sufficiently, the stance of policy will need to be tightened to prevent inflation from rising above levels consistent with price stability and to keep economic activity near its maximum sustainable level. The FOMC is confident that it has the necessary tools to withdraw policy accommodation, when such action becomes appropriate, in a smooth and timely manner.

Monetary policy actions taken over the past year have led to a considerable increase in the assets held by the Federal Reserve. This increase in assets reflects both the expansion of Federal Reserve liquidity facilities and the purchases of longer-term securities. On the margin, the extension of credit and acquisition of assets by the Federal Reserve has been funded by crediting the reserve accounts of depository institutions (henceforth referred to as banks). Thus, the increase in Federal Reserve assets has been associated with substantial growth in banks' reserve balances, leaving the level of reserves far above that typically observed when short-term interest rates were significantly greater than zero.

To some extent, a contraction in the stock of reserve balances will occur automatically as financial conditions improve. In particular, most of the liquidity facilities deployed by the Federal Reserve in the current period of financial turmoil are priced at a premium over normal interest rate spreads or have a minimum bid rate that is high enough to make them unattractive under normal market conditions. Thus, the sizes of these programs, as well as the stock of reserve balances they create, will tend to diminish automatically as financial strains abate. Indeed, as

tions to a Number of Its Liquidity Programs," press release, June 25.

Federal Reserve Initiatives to Increase Transparency

The Federal Reserve took a number of nontraditional policy actions during the current episode of financial turmoil. In late 2008, Chairman Bernanke asked Vice Chairman Kohn to lead a review of how Federal Reserve disclosure policies should be adapted to make more information about these programs available to the public and to the Congress. A guiding principle of the review was that the Federal Reserve would seek to provide to the public as much information and analysis as possible, consistent with its objectives of promoting maximum employment and price stability. The Federal Reserve subsequently created a separate section of its website devoted to providing data, explanations, and analyses of its lending programs and balance sheet.[1] Postings in the first half of 2009 included additional explanatory material and details about a number of Federal Reserve credit and liquidity programs, the annual financial statements of the 12 Federal Reserve Banks, the Board of Governors, and the limited liability companies (LLCs) created in 2008 to avert the disorderly failures of The Bear Stearns Companies, Inc., and American International Group, Inc., as well as the most recent reports to the Congress on the Federal Reserve's emergency lending programs.

On June 10, the Federal Reserve issued the first of a series of monthly reports to provide more information on its credit and liquidity programs.[2] For many of those programs, the new information provided in the report includes the number of borrowers and the amounts borrowed by type of institution, collateral by type and credit rating, and data on the concentration of borrowing. The report also includes information on liquidity swap usage by country, quarterly income earned on different classes of Federal Reserve assets, and asset distribution and other information on the LLCs. In addition, the report summarizes and discusses recent developments across a number of Federal Reserve programs. In addition to the new report, the Federal Reserve Bank of New York recently made available the investment management agreements related to its financial stability and liquidity activities.[3]

1. This section of the Board's website is available at www.federalreserve.gov/monetarypolicy/bst.htm.

2. See Board of Governors of the Federal Reserve System (2009), *Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet* (Washington: Board of Governors, July).

3. Federal Reserve Bank of New York (2009), "Vendor Information," www.newyorkfed.org/aboutthefed/vendor_information.html.

noted elsewhere in this report, total credit extended to banks and other market participants (excluding support of critical institutions) declined from about $1.5 trillion as of December 31, 2008, to less than $600 billion as of July 15, 2009, as financial conditions improved. In addition, redemptions of the Federal Reserve's holdings of agency debt, agency MBS, and longer-term Treasury securities are expected to occur at a rate of $100 billion to $200 billion per year over the next few years, leading to further reductions in reserve balances.

But even after lending facilities have wound down and holdings of long-term assets have begun to run off, the volume of assets on the Federal Reserve's balance sheet may remain very large for some time. Without additional actions, the level of bank reserves would continue to remain elevated as well.

Despite continued large holdings of assets, the Federal Reserve will have at its disposal two broad means of tightening monetary policy at the appropriate time. In principle, either of these methods would suffice to raise short-term interest rates; however, to ensure effectiveness, the two methods will most likely be used in combination.

The first method for tightening monetary policy relies on the authority that the Congress granted to the Federal Reserve last fall to pay interest on the balances maintained by banks. By raising the rate it pays on banks' reserve balances, the Federal Reserve will be able to tighten monetary policy by inducing increases in the federal funds rate and other short-term market interest rates. In general, banks will not supply funds to the money market at an interest rate lower than the rate they can earn risk free at the Federal Reserve. Moreover, they should compete to borrow any funds that are offered in the market at rates below the rate of interest paid by the Federal Reserve, as such borrowing allows them to earn a spread without any risk. Thus, raising the interest rate paid on balances that banks hold at the Federal Reserve should provide a powerful upward influence on short-term market interest rates, including the federal funds rate, without the need to drain reserve balances. A number of foreign central banks have been able to maintain overnight interbank interest rates at or above the level of interest paid on bank reserves even in the presence of unusually high levels of reserve balances (see the box titled "Foreign Experience with Interest on Reserves").

Despite this logic, the federal funds rate has been somewhat lower than the rate of interest banks earn on reserve balances; the gap was especially noticeable in October and November 2008, when payment of interest on reserves first began. This gap appears to have reflected several factors: First, the Federal Reserve is not allowed to pay interest on balances held by nondepository institutions, including some large lenders in the federal funds market such as the government-sponsored enterprises (GSEs). Such institutions may have an incentive to lend at rates below the rate that banks receive on reserve balances. Second, the payment of interest on reserves was a new policy at the time that the gap was particularly noticeable, and banks may not have had time to adjust their operations to the new regime. Third, the unusually strained conditions in financial markets at that time may have reduced the willingness of banks to arbitrage by borrowing in the federal funds market at rates below the rate paid on reserve balances and earning a higher rate by increasing their deposits at the Federal Reserve. The latter two factors are not likely to persist, particularly as the economy and financial markets recover. Moreover, if, as the economy recovers, large-scale lending in the federal funds market by nondepository institutions threatens to hold the federal funds rate below its target, the Federal Reserve has various options to deal with the problem. For example, it could offer these institutions the option of investing in reverse repurchase agreements. Under these transactions, the Federal Reserve sells securities from its portfolio, thereby removing funds from the market, and agrees to buy back the securities at a later date.[15] Eliminating the incentive of nondepository institutions to lend their excess funds into

15. These transactions are referred to as reverse repurchase agreements to distinguish them from repurchase agreements in which the Federal Reserve is the investor.

Foreign Experience with Interest on Reserves

Paying interest on excess reserve balances, either directly or by allowing banks to place excess balances into an interest-bearing account, is a standard tool used by major foreign central banks. Many have used interest on reserves, in combination with other tools, to maintain a floor under overnight interbank interest rates both in normal circumstances and during the period of financial turmoil. The European Central Bank (ECB), for example, has long allowed banks to place excess reserves into a deposit facility that pays interest at a rate below the ECB's main refinancing rate (its bellwether policy rate). The quantity of funds that banks hold in that facility increased sharply as the ECB expanded its liquidity-providing operations last fall and has remained well above pre-crisis levels; as a result, the euro-area overnight interbank rate fell from a level close to the main refinancing rate toward the rate the ECB pays on deposits—but, importantly, not below that rate. Since November 2008, the Bank of Japan (BOJ) on a temporary basis has paid interest on excess reserve balances, at a rate of 10 basis points per year, which is also its current target for the overnight uncollateralized call rate; the BOJ noted that its action was intended to keep the call rate close to the targeted level as it supplied additional liquidity to the banking system. Indeed, the overnight rate has traded near 10 basis points in recent months, even as reserve balances at the BOJ have risen substantially, returning to their level during much of 2002, when the BOJ was implementing its Quantitative Easing Policy and the call rate was trading at 1 basis point or below. The Bank of Canada and the Bank of England also have used their standing deposit facilities to help manage interbank interest rates.

short-term money markets would help ensure that raising the rate of interest paid on reserves would raise the federal funds rate and tighten monetary conditions even if the level of reserve balances were to remain high.

The second method for tightening monetary policy, despite a high level of assets on the Federal Reserve's balance sheet, is to take steps to reduce the overall level of reserve balances. Policymakers have several options for reducing the level of reserve balances should such action be desired. First, the Federal Reserve could engage in large-scale reverse repurchase agreements with financial market participants, including GSEs as well as other institutions. Reverse repurchase agreements are a traditional tool of Federal Reserve monetary policy implementation. Second, the Treasury could sell more bills and deposit the proceeds with the Federal Reserve. The Treasury has been conducting such operations since last fall; the resulting deposits are reported on the Federal Reserve balance sheet as the Supplementary Financing Account. One limitation on this option is that the associated Treasury debt is subject to the statutory debt ceiling. Also, to preserve monetary policy independence, the Federal Reserve must ensure that it can achieve its policy objectives without reliance on the Treasury if necessary. A third option is for the Federal Reserve to offer banks the opportunity to hold some of their balances as term deposits. Such deposits would pay interest but would not have the liquidity and transactions features of reserve balances. Term deposits could not be counted toward reserve requirements, nor could they be used to avoid overnight overdraft penalties in reserve accounts.[16] Each of these three policy options would allow a tightening of monetary policy by draining reserve balances and raising short-term interest rates. As noted earlier, measures to drain reserves will likely be used in conjunction with increases in the interest rate paid on reserves to tighten conditions in short-term money markets.

Raising the rate of interest on reserve balances and draining reserves through the options just described would allow policy to be tightened even if the level of assets on the Federal Reserve's balance sheet remained very high. In addition, the Federal Reserve retains the option to reduce its stock of assets by selling off a portion of its holdings of longer-term securities before they mature. Asset sales by the Federal Reserve would serve to raise short-term interest rates and tighten monetary policy by reducing the level of reserve balances; in addition, such sales could put upward pressure on longer-term interest rates by expanding the supply of longer-term assets available to investors. In an environment of strengthening economic activity and rising inflation pressures, broad-based increases in interest rates could facilitate the achievement of the Federal Reserve's dual mandate.

In short, the Federal Reserve has a wide range of tools that can be used to tighten the stance of monetary policy at the point that the economic outlook calls for such action. However, economic conditions are not likely to warrant a tightening of monetary policy for an extended period. The timing and pace of any future tightening, together with the mix of tools employed, will be calibrated to best foster the Federal Reserve's dual objectives of maximum employment and price stability. ■

16. To be successful, especially in a period of rising interest rates, such deposits likely would have to pay rates of interest above the overnight rate on reserve balances. To prevent banks from earning risk-free profits by borrowing from the Federal Reserve and investing the proceeds in term deposits, the rate of remuneration on term deposits would have to be kept lower than the rates the Federal Reserve charges on its lending facilities, such as the discount window.

Federal Reserve Operations

Banking Supervision and Regulation

The Federal Reserve has supervisory and regulatory authority over a variety of financial institutions and activities. It plays an important role as the consolidated supervisor of bank holding companies (BHCs), including financial holding companies. And it is the primary federal supervisor of state banks that are members of the Federal Reserve System.

In the midst of general improvements in financial markets throughout the course of 2009, U.S. BHCs and state member banks continued to face substantial challenges. As a group, BHCs returned to profitability in 2009, reporting $14.5 billion in earnings following a $30.7 billion loss in 2008. But 41 percent of all BHCs representing 36.3 percent of assets reported losses in 2009. Improved market conditions boosted trading revenues and triggered appreciation in securities portfolios. Although BHC assets grew 15.2 percent from 2008, lending contracted 2.9 percent. The nonperforming assets ratio escalated to 4.7 percent of loans and foreclosed assets, an 18-year high. Weaknesses were broad based, encompassing residential mortgages (first-lien), commercial real estate—especially non-owner nonfarm nonresidential and construction other than single-family—and commercial and industrial (C&I) loans. BHC capital ratios improved substantially during 2009. Of the 596 BHCs that received funds from the U.S. Department of Treasury's (Treasury) Troubled Asset Relief Program (TARP), 57 have repaid all funds received; approximately 66 percent of all funds distributed have been repaid.

State member banks faced challenges similar to those faced by BHCs in 2009. As a group, state member banks sustained losses of $4.4 billion in 2009—in part attributed to a special assessment by the Federal Deposit Insurance Corporation (FDIC) and somewhat less than the $4.8 billion loss incurred in 2008. Earnings remained lackluster due to elevated provision levels and a sizable increase in securities losses to $4.2 billion, but benefited from higher trading revenue as market conditions improved. Mirroring trends at BHCs, the nonperforming assets ratio escalated to 4.6 percent of loans and foreclosed assets, reflecting both contracting loan balances and weakening asset quality. Construction lending accounted for one-third of the growth in problem loans, but weakness encompassed nonfarm nonresidential lending, residential mortgages, and C&I loans. The risk-based capital ratios for state member banks improved over 2009 in the aggregate, but the percent of state member banks deemed well capitalized by ratios, consistent with the designation under prompt corrective action standards, dropped to 96 percent from 98 percent at year-end 2008. State member banks repaid approximately $19.3 billion or 48 percent of funds received from TARP. In 2009, 16 state member banks with $13.4 billion in assets failed, with losses of $3.6 billion according to FDIC estimates.

In response to the market turmoil of 2008, Treasury and the Federal Reserve, working with other federal banking agencies, initiated the Supervisory Capital Assessment Program

(SCAP). Popularly known as the bank "stress test," the SCAP was designed to ensure that 19 of the largest U.S. BHCs had sufficient financial strength to absorb losses under a more adverse than expected macroeconomic scenario, while remaining sufficiently capitalized to meet the needs of their creditworthy borrowers. As a result of our analysis, it was determined that 10 of the BHCs assessed under SCAP needed to augment their capital by a combined total of $185 billion, almost all in the form of common equity. The transparency around supervisors' loss estimates increased investor confidence in the banking system and helped open the public equity markets to these institutions. Actions taken by the 10 BHCs needing to increase their capital buffer, together with related actions to support repayment of Treasury capital by the 19 banking organizations, increased their aggregate tier 1 common capital by nearly $200 billion. In conjunction with these efforts, the Federal Reserve issued guidance on BHCs' capital planning in March 2009. All of these actions have significantly improved the quality of capital across the largest U.S. banking organizations.

In October 2009, the Federal Reserve issued interagency guidance on commercial real estate (CRE) loan restructurings and workouts.[1] This policy statement provides guidance for examiners and for financial institutions that are working with CRE borrowers who are experiencing diminished operating cash flows, depreciated collateral values, or prolonged delays in selling or renting commercial properties. The statement is especially relevant to small businesses because owner-occupied CRE often serves as collateral for many small business loans. To underscore expectations regarding the guidance, the Federal Reserve conducted extensive outreach to examiners and the industry.

During 2009, the Federal Reserve continued to work with banking organizations to correct some of the risk-management weaknesses revealed by the financial crisis that began in mid-2007. These supervisory activities covered a number of areas, including firmwide risk identification, senior management oversight, and liquidity risk management. Where institutions did not make appropriate progress, supervisors downgraded supervisory ratings and used enforcement tools to bring about corrective action.

Federal Reserve staff continued to work with the other federal banking agencies to implement the advanced approaches of the Basel II Capital Accord in the United States, with the final rule taking effect on April 1, 2008.[2] A number of institutions have begun their transition to the new rules after having developed implementation plans and worked to put in place systems that will comply with the final rule's qualification requirements.

In light of identified supervisory lessons learned, the Federal Reserve plans to augment its processes for conducting

1. Interagency Policy Statement on Prudent CRE Loan Restructurings and Workouts (November 2009); www.federalreserve.gov/newsevents/press/bcreg/20091030a.htm.

2. The Basel II Capital Accord, an international agreement formally titled "International Convergence of Capital Measurement and Capital Standards: A Revised Framework," was developed by the Basel Committee on Banking Supervision, which is made up of representatives of the central banks or other supervisory authorities of 19 countries. The original document was issued in 2004; the original version and an updated version issued in November 2005 are available on the website of the Bank for International Settlements (www.bis.org).

examinations and inspections as needed, as well as its processes for ensuring that there is appropriate follow-up with institutions about issues identified during examinations and inspections.

Scope of Responsibilities for Supervision and Regulation

The Federal Reserve is the federal supervisor and regulator of all U.S. BHCs, including financial holding companies formed under the authority of the 1999 Gramm-Leach-Bliley Act, and state-chartered commercial banks that are members of the Federal Reserve System. In overseeing these organizations, the Federal Reserve seeks primarily to promote their safe and sound operation, including their compliance with laws and regulations.

The Federal Reserve also has responsibility for supervising the operations of all Edge Act and agreement corporations, the international operations of state member banks and U.S. BHCs, and the U.S. operations of foreign banking organizations.

The Federal Reserve exercises important regulatory influence over entry into the U.S. banking system, and the structure of the system, through its administration of the Bank Holding Company Act, the Bank Merger Act (with regard to state member banks), the Change in Bank Control Act (with regard to BHCs and state member banks), and the International Banking Act. The Federal Reserve is also responsible for imposing margin requirements on securities transactions. In carrying out these responsibilities, the Federal Reserve coordinates its supervisory activities with the other federal banking agencies, state agencies, functional regulators (that is, regulators for insurance, securities, and commodities firms), and the bank regulatory agencies of other nations.

Supervision for Safety and Soundness

To promote the safety and soundness of banking organizations, the Federal Reserve conducts on-site examinations and inspections and off-site surveillance and monitoring. It also takes enforcement and other supervisory actions as necessary.

Examinations and Inspections

The Federal Reserve conducts examinations of state member banks, the U.S. branches and agencies of foreign banks, and Edge Act and agreement corporations. In a process distinct from examinations, it conducts inspections of BHCs and their nonbank subsidiaries. Whether an examination or an inspection is being conducted, the review of operations entails (1) an evaluation of the adequacy of governance provided by the board and senior management, including an assessment of internal policies, procedures, controls, and operations; (2) an assessment of the quality of the risk-management and internal control processes in place to identify, measure, monitor, and control risks; (3) an assessment of the key financial factors of capital, asset quality, earnings, and liquidity; and (4) a review for compliance with applicable laws and regulations. The accompanying table (see next page) provides information on examinations and inspections conducted by the Federal Reserve during the past five years.

Inspections of BHCs, including financial holding companies, are built around a rating system introduced in 2005 that reflects the shift in supervisory practices away from a historical

State Member Banks and Bank Holding Companies, 2005–2009

Entity/Item	2009	2008	2007	2006	2005
State member banks					
Total number	845	862	878	901	907
Total assets (billions of dollars)	1,690	1,854	1,519	1,405	1,318
Number of examinations	850	717	694	761	783
By Federal Reserve System	655	486	479	500	563
By state banking agency	195	231	215	261	220
Top-tier bank holding companies					
Large (assets of more than $1 billion)					
Total number	488	485	459	448	394
Total assets (billions of dollars)	15,744	14,138	13,281	12,179	10,261
Number of inspections	658	519	492	566	501
By Federal Reserve System[1]	640	500	476	557	496
On site	501	445	438	500	457
Off site	139	55	38	57	39
By state banking agency	18	19	16	9	5
Small (assets of $1 billion or less)					
Total number	4,486	4,545	4,611	4,654	4,760
Total assets (billions of dollars)	1,018	1,008	974	947	890
Number of inspections	3,264	3,192	3,186	3,449	3,420
By Federal Reserve System	3,109	3,048	3,007	3,257	3,233
On site	169	107	120	112	170
Off site	2,940	2,941	2,887	3,145	3,063
By state banking agency	155	144	179	192	187
Financial holding companies					
Domestic	479	557	597	599	591
Foreign	46	45	43	44	38

1. For large bank holding companies subject to continuous, risk-focused supervision, includes multiple targeted reviews.

analysis of financial condition toward a more dynamic, forward-looking assessment of risk-management practices and financial factors. Under the system, known as RFI but more fully termed RFI/C(D), holding companies are assigned a composite rating (C) that is based on assessments of three components: Risk Management (R), Financial Condition (F), and the potential Impact (I) of the parent company and its nondepository subsidiaries on the subsidiary depository institution.[3] The fourth component, Depository Institution (D), is intended to mirror the primary supervisor's rating of the subsidiary depository institution.

The Federal Reserve uses a risk-focused approach to supervision, with activities focused on identifying the areas of greatest risk to banking organizations and assessing the ability of the organizations' management processes for identifying, measuring, monitoring, and controlling those risks. Key aspects of the risk-focused approach to consolidated supervision of large complex banking organizations (LCBOs) include (1) developing an understanding of each LCBO's legal and operating structure, and its primary strategies, business lines, and risk-management and internal control functions; (2) developing and executing a tailored supervisory plan outlining the work required to maintain a comprehensive understanding and assessment of each LCBO, incorporating reliance to the

3. Each of the first two components has four subcomponents: Risk Management—(1) Board and Senior Management Oversight; (2) Policies, Procedures, and Limits; (3) Risk Monitoring and Management Information Systems; and (4) Internal Controls. Financial Condition—(1) Capital; (2) Asset Quality; (3) Earnings; and (4) Liquidity.

fullest extent possible on assessments and information developed by other relevant domestic and foreign supervisors and functional regulators; (3) maintaining continual supervision of these organizations—including through meetings with banking organization management and analysis of internal and external information—so that the Federal Reserve's understanding and assessment of each organization's condition remains current; (4) assigning to each LCBO a supervisory team composed of Reserve Bank staff members who have skills appropriate for the organization's risk profile (the team leader is the Federal Reserve System's central point of contact for the organization, has responsibility for only one LCBO, and is supported by specialists capable of evaluating the risks of LCBO business activities and functions and assessing the LCBO's consolidated financial condition); and (5) promoting Systemwide and interagency information-sharing through automated systems and other mechanisms.

For other banking organizations, the risk-focused consolidated supervision program provides that examination and inspection procedures are tailored to each banking organization's size, complexity, risk profile, and condition. As with the LCBOs, these supervisory programs entail both off-site and on-site work, including planning, preexamination visits, detailed documentation, and examination reports tailored to the scope and findings of the examination.

State Member Banks

At the end of 2009, 845 state-chartered banks (excluding nondepository trust companies and private banks) were members of the Federal Reserve System. These banks represented approximately 12 percent of all insured U.S. commercial banks and held approximately 14 percent of all insured commercial bank assets in the United States.

The guidelines for Federal Reserve examinations of state member banks are fully consistent with section 10 of the Federal Deposit Insurance Act, as amended by section 111 of the Federal Deposit Insurance Corporation Improvement Act of 1991 and by the Riegle Community Development and Regulatory Improvement Act of 1994. A full-scope, on-site examination of these banks is required at least once a year, although certain well-capitalized, well-managed organizations having total assets of less than $500 million may be examined once every 18 months.[4] The Federal Reserve conducted 655 exams of state member banks in 2009.

Bank Holding Companies

At year-end 2009, a total of 5,634 U.S. BHCs were in operation, of which 4,974 were top-tier BHCs. These organizations controlled 5,710 insured commercial banks and held approximately 99 percent of all insured commercial bank assets in the United States.

Federal Reserve guidelines call for annual inspections of large BHCs and complex smaller companies. In judging the financial condition of the subsidiary banks owned by holding companies, Federal Reserve examiners consult examination reports prepared by the federal and state banking authorities that have primary responsibility for the supervision of those banks, thereby

4. The Financial Services Regulatory Relief Act of 2006, which became effective in October 2006, authorized the federal banking agencies to raise the threshold from $250 million to $500 million, and final rules incorporating the change into existing regulations were issued on September 21, 2007.

minimizing duplication of effort and reducing the supervisory burden on banking organizations. Noncomplex BHCs with consolidated assets of $1 billion or less are subject to a special supervisory program that permits a more flexible approach.[5] In 2009, the Federal Reserve conducted 640 inspections of large BHCs and 3,109 inspections of small, noncomplex BHCs.

Financial Holding Companies

Under the Gramm-Leach-Bliley Act, BHCs that meet certain capital, managerial, and other requirements may elect to become financial holding companies and thereby engage in a wider range of financial activities, including full-scope securities underwriting, merchant banking, and insurance underwriting and sales. The statute streamlines the Federal Reserve's supervision of all BHCs, including financial holding companies, and sets forth parameters for the supervisory relationship between the Federal Reserve and other regulators. The statute also differentiates between the Federal Reserve's relations with regulators of depository institutions and its relations with functional regulators.

As of year-end 2009, 479 domestic BHCs and 46 foreign banking organizations had financial holding company status. Of the domestic financial holding companies, 35 had consolidated assets of $15 billion or more; 111, between $1 billion and $15 billion; 74, between $500 million and $1 billion; and 259, less than $500 million.

5. The special supervisory program was implemented in 1997 and modified in 2002. See SR letter 02-01 for a discussion of the factors considered in determining whether a BHC is complex or noncomplex, (www.federalreserve.gov/boarddocs/srletters/).

International Activities

The Federal Reserve supervises the foreign branches and overseas investments of member banks, Edge Act and agreement corporations, and BHCs and also the investments by BHCs in export trading companies. In addition, it supervises the activities that foreign banking organizations conduct through entities in the United States, including branches, agencies, representative offices, and subsidiaries.

Foreign Operations of U.S. Banking Organizations

In supervising the international operations of state member banks, Edge Act and agreement corporations, and BHCs, the Federal Reserve generally conducts its examinations or inspections at the U.S. head offices of these organizations, where the ultimate responsibility for the foreign offices lies. Examiners also visit the overseas offices of U.S. banks to obtain financial and operating information and, in some instances, to evaluate the organization's efforts to implement corrective measures or to test their adherence to safe and sound banking practices. Examinations abroad are conducted with the cooperation of the supervisory authorities of the countries in which they take place; for national banks, the examinations are coordinated with the Office of the Comptroller of the Currency (OCC).

At the end of 2009, 53 member banks were operating 557 branches in foreign countries and overseas areas of the United States; 32 national banks were operating 503 of these branches, and 21 state member banks were operating the remaining 54. In addition, 18 nonmember banks were operating 26 branches in foreign countries and overseas areas of the United States.

Edge Act and Agreement Corporations

Edge Act corporations are international banking organizations chartered by the Board to provide all segments of the U.S. economy with a means of financing international business, especially exports. Agreement corporations are similar organizations, state chartered or federally chartered, that enter into agreements with the Board to refrain from exercising any power that is not permissible for an Edge Act corporation.

Sections 25 and 25A of the Federal Reserve Act grant Edge Act and agreement corporations permission to engage in international banking and foreign financial transactions. These corporations, most of which are subsidiaries of member banks, may (1) conduct a deposit and loan business in states other than that of the parent, provided that the business is strictly related to international transactions, and (2) make foreign investments that are broader than those permissible for member banks.

At year-end 2009, 55 banking organizations, operating 10 branches, were chartered as Edge Act or agreement corporations. These corporations are examined annually.

U.S. Activities of Foreign Banks

The Federal Reserve has broad authority to supervise and regulate the U.S. activities of foreign banks that engage in banking and related activities in the United States through branches, agencies, representative offices, commercial lending companies, Edge Act corporations, commercial banks, BHCs, and certain nonbanking companies. Foreign banks continue to be significant participants in the U.S. banking system.

As of year-end 2009, 176 foreign banks from 53 countries were operating 204 state-licensed branches and agencies, of which 6 were insured by the FDIC, and 50 OCC-licensed branches and agencies, of which 4 were insured by the FDIC. These foreign banks also owned 8 Edge Act and agreement corporations and 3 commercial lending companies; in addition, they held a controlling interest in 58 U.S. commercial banks. Altogether, the U.S. offices of these foreign banks at the end of 2009 controlled approximately 17 percent of U.S. commercial banking assets. These 176 foreign banks also operated 78 representative offices; an additional 58 foreign banks operated in the United States through a representative office.

State-licensed and federally licensed branches and agencies of foreign banks are examined on-site at least once every 18 months, either by the Federal Reserve or by a state or other federal regulator. In most cases, on-site examinations are conducted at least once every 12 months, but the period may be extended to 18 months if the branch or agency meets certain criteria.

In cooperation with the other federal and state banking agencies, the Federal Reserve conducts a joint program for supervising the U.S. operations of foreign banking organizations. The program has two main parts. One part involves examination of those foreign banking organizations that have multiple U.S. operations and is intended to ensure coordination among the various U.S. supervisory agencies. The other part is a review of the financial and operational profile of each organization to assess its general ability to support its U.S. operations and to determine what risks, if any, the organization poses through its U.S. operations. Together, these two processes provide critical information to U.S. supervisors in a logical, uniform, and timely manner. The Federal Reserve conducted or participated with state and federal banking agencies in 430 examinations in 2009.

Compliance with Regulatory Requirements

The Federal Reserve examines institutions for compliance with a broad range of legal requirements, including anti-money-laundering and consumer protection laws and regulations, and other laws pertaining to certain banking and financial activities. Most compliance supervision is conducted under the oversight of the Board's Division of Banking Supervision and Regulation, but consumer compliance supervision is conducted under the oversight of the Division of Community and Consumer Affairs. The two divisions coordinate their efforts with each other and also with the Board's Legal Division to ensure consistent and comprehensive Federal Reserve supervision for compliance with legal requirements.

Anti-Money-Laundering Examinations

The Treasury regulations implementing the Bank Secrecy Act (BSA) generally require banks and other types of financial institutions to file certain reports and maintain certain records that are useful in criminal, tax, or regulatory proceedings. The BSA and separate Board regulations require banking organizations supervised by the Board to file reports on suspicious activity related to possible violations of federal law, including money laundering, terrorism financing, and other financial crimes. In addition, BSA and Board regulations require that banks develop written BSA compliance programs and that the programs be formally approved by bank boards of directors. The Federal Reserve is responsible for examining institutions for compliance with applicable anti-money-laundering laws and regulations and conducts such examinations in accordance with the Federal Financial Institutions Examination Council (FFIEC) *Bank Secrecy Act/Anti-Money Laundering Examination Manual*.[6]

Specialized Examinations

The Federal Reserve conducts specialized examinations of banking organizations in the areas of information technology, fiduciary activities, transfer agent activities, and government and municipal securities dealing and brokering. The Federal Reserve also conducts specialized examinations of certain nonbank entities that extend credit subject to the Board's margin regulations.

Information Technology Activities

In recognition of the importance of information technology to safe and sound operations in the financial industry, the Federal Reserve reviews the information technology activities of supervised banking organizations as well as certain independent data centers that provide information technology services to these organizations. All safety and soundness examinations include a risk-focused review of information technology risk-management activities. During 2009, the Federal Reserve continued as

6. The FFIEC is an interagency body of financial regulatory agencies established to prescribe uniform principles, standards, and report forms and to promote uniformity in the supervision of financial institutions. The Council has six voting members: the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the chair of the State Liaison Committee.

the lead agency in three interagency examinations of large, multiregional data processing servicers, and it assumed leadership in one additional examination.

Fiduciary Activities

The Federal Reserve has supervisory responsibility for state member banks and state member nondepository trust companies that reported $43.3 trillion and $33.9 trillion of assets, respectively, as of year-end 2009, held in various fiduciary and custodial capacities. On-site examinations of fiduciary and custody activities are risk-focused and entail the review of an organization's compliance with laws, regulations, and general fiduciary principles, including effective management of conflicts of interest; management of legal, operational, and reputational risk exposures; and audit and control procedures. In 2009, Federal Reserve examiners conducted 68 on-site fiduciary examinations, excluding transfer agent examinations, of state member banks.

Transfer Agents

As directed by the Securities Exchange Act of 1934, the Federal Reserve conducts specialized examinations of those state member banks and BHCs that are registered with the Board as transfer agents. Among other things, transfer agents countersign and monitor the issuance of securities, register the transfer of securities, and exchange or convert securities. On-site examinations focus on the effectiveness of an organization's operations and its compliance with relevant securities regulations. During 2009, the Federal Reserve conducted on-site transfer agent examinations at 16 of the 49 state member banks and BHCs that were registered as transfer agents.

Government and Municipal Securities Dealers and Brokers

The Federal Reserve is responsible for examining state member banks and foreign banks for compliance with the Government Securities Act of 1986 and with the Treasury regulations governing dealing and brokering in government securities. Eleven state member banks and four state branches of foreign banks have notified the Board that they are government securities dealers or brokers not exempt from the Treasury's regulations. During 2009, the Federal Reserve conducted five examinations of broker-dealer activities in government securities at these organizations. These examinations are generally conducted concurrently with the Federal Reserve's examination of the state member bank or branch.

The Federal Reserve is also responsible for ensuring that state member banks and BHCs that act as municipal securities dealers comply with the Securities Act Amendments of 1975. Municipal securities dealers are examined pursuant to the Municipal Securities Rulemaking Board's rule G-16 at least once every two calendar years. Of the 11 entities that dealt in municipal securities during 2009, five were examined during the year.

Securities Credit Lenders

Under the Securities Exchange Act of 1934, the Board is responsible for regulating credit in certain transactions involving the purchase or carrying of securities. As part of its general examination program, the Federal Reserve examines the banks under its jurisdiction for compliance with the Board's

Regulation U (Credit by Banks and Persons other than Brokers or Dealers for the Purpose of Purchasing or Carrying Margin Stock). In addition, the Federal Reserve maintains a registry of persons other than banks, brokers, and dealers who extend credit subject to Regulation U. The Federal Reserve may conduct specialized examinations of these lenders if they are not already subject to supervision by the Farm Credit Administration (FCA) or the National Credit Union Administration (NCUA).

At the end of 2009, 566 lenders other than banks, brokers, or dealers were registered with the Federal Reserve. Other federal regulators supervised 186 of these lenders, and the remaining 380 were subject to limited Federal Reserve supervision. The Federal Reserve exempted 168 lenders from its on-site inspection program on the basis of their regulatory status and annual reports. Fifty-one inspections were conducted during the year.

Business Continuity/Pandemic Preparedness

In 2009, the Federal Reserve continued its efforts to strengthen the resilience of the U.S. financial system in the event of unexpected disruptions, including focused supervisory efforts to evaluate the resiliency of the banking institutions under its jurisdiction. Particular emphasis was placed on large institutions' preparedness for a pandemic-like event and on the resiliency requirements imposed on core and significant market firms under the *Interagency Paper on Sound Practices to Strengthen the Resilience of the U.S. Financial System.*[7]

The Federal Reserve, together with other federal and state financial regulators, is a member of the Financial Banking Information Infrastructure Committee (FBIIC), which was formed to improve coordination and communication among financial regulators, enhance the resilience of the U.S. financial sector, and promote the public/private partnership. The FBIIC has established emergency communication protocols to maintain effective communication among members in the event of an emergency. The FBIIC protocols were active at various points in 2009 to monitor the status and impact of the H1N1 flu outbreak and each time a significant storm made landfall in the United States.

In January 2009, the Federal Reserve and the other FFIEC agencies participated in a pandemic-related tabletop exercise conducted through the FFIEC Task Force on Supervision. The exercise accomplished the following main objectives: validate current interagency pandemic planning and identify existing gaps in communications; share agency key response triggers, emphasizing response activation and resumption of normal business; consider ramifications of national infrastructure limitations; and review response context for any needed policymaking.

In September 2009, the Federal Reserve joined other financial regulatory agencies, the Financial Services Sector Coordinating Council, and the Financial Services Information Sharing and Analysis Center in conducting the Cyber Financial Industry and Regulators Exercise of 2009. This exercise brought together 76 registered partici-

7. The population under review included core clearing and settlement organizations and firms that play a critical role in financial markets and are subject to resiliency guidelines issued in April 2003, also called the "Sound Practices Paper."

pants, including regulators, exchanges, and firms from across the financial services sector to respond to a series of disruptive scenario events. One of the primary objectives of the exercise was to develop a better understanding of the dependencies of the sector upon the information and communications infrastructure that may impact the sector's security and resilience.

Enforcement Actions

The Federal Reserve has enforcement authority over the banking organizations it supervises and their affiliated parties. Enforcement actions may be taken to address unsafe and unsound practices or violations of any law or regulation. Formal enforcement actions include cease-and-desist orders, written agreements, removal and prohibition orders, and civil money penalties. In 2009, the Federal Reserve completed 191 formal enforcement actions. Civil money penalties totaling $249,570 were assessed. As directed by statute, all civil money penalties are remitted to either the Treasury or the Federal Emergency Management Agency. Enforcement orders and prompt corrective action directives, which are issued by the Board, and written agreements, which are executed by the Reserve Banks, are made public and are posted on the Board's website (www.federalreserve.gov/boarddocs/enforcement/).

In addition to taking these formal enforcement actions, the Reserve Banks completed 467 informal enforcement actions in 2009. Informal enforcement actions include memoranda of understanding and board of directors resolutions. Information about these actions is not available to the public.

Surveillance and Off-Site Monitoring

The Federal Reserve uses automated screening systems to monitor the financial condition and performance of state member banks and BHCs between on-site examinations. Such monitoring and analysis helps direct examination resources to institutions that have higher risk profiles. Screening systems also assist in the planning of examinations by identifying companies that are engaging in new or complex activities.

The primary off-site monitoring tool used by the Federal Reserve is the Supervision and Regulation Statistical Assessment of Bank Risk model (SR-SABR). Drawing mainly on the financial data that banks report on their Reports of Condition and Income (Call Reports), SR-SABR uses econometric techniques to identify banks that report financial characteristics weaker than those of other banks assigned similar supervisory ratings. To supplement the SR-SABR screening, the Federal Reserve also monitors various market data, including equity prices, debt spreads, agency ratings, and measures of expected default frequency, to gauge market perceptions of the risk in banking organizations. In addition, the Federal Reserve prepares quarterly Bank Holding Company Performance Reports (BHCPRs) for use in monitoring and inspecting supervised banking organizations. The BHCPRs, which are compiled from data provided by large BHCs in quarterly regulatory reports (FR Y-9C and FR Y-9LP), contain, for individual companies, financial statistics and comparisons with peer companies. BHCPRs are made available to the public on the National Information Center (NIC) website, which can be accessed at www.ffiec.gov.

During 2009, three major upgrades to the web-based Performance Report Information and Surveillance Monitoring (PRISM) application were completed. PRISM is a querying tool used by Federal Reserve analysts to access and display financial, surveillance, and examination data. In the analytical module, users can customize the presentation of institutional financial information drawn from Call Reports, Uniform Bank Performance Reports, FR Y-9 statements, BHCPRs, and other regulatory reports. In the surveillance module, users can generate reports summarizing the results of surveillance screening for banks and BHCs.

The Federal Reserve works through the FFIEC Task Force on Surveillance Systems to coordinate surveillance activities with the other federal banking agencies.

International Training and Technical Assistance

In 2009, the Federal Reserve continued to provide technical assistance on bank supervisory matters to foreign central banks and supervisory authorities. Technical assistance involves visits by Federal Reserve staff members to foreign authorities as well as consultations with foreign supervisors who visit the Board or the Reserve Banks. The Federal Reserve, along with the OCC, the FDIC, and the Treasury, was an active participant in the Middle East and North Africa Financial Regulators' Training Initiative, which is part of the U.S. government's Middle East Partnership Initiative. The Federal Reserve also contributes to the regional training provision under the Asia Pacific Economic Cooperation Financial Regulators' Training Initiative.

In 2009, the Federal Reserve offered a number of training courses exclusively for foreign supervisory authorities, both in the United States and in a number of foreign jurisdictions. System staff also took part in technical assistance and training missions led by the International Monetary Fund, the World Bank, the Asian Development Bank, the Basel Committee on Banking Supervision (Basel Committee), and the Financial Stability Institute.

The Federal Reserve is also an associate member of the Association of Supervisors of Banks of the Americas (ASBA), an umbrella group of bank supervisors from countries in the Western Hemisphere. The group, headquartered in Mexico, promotes communication and cooperation among bank supervisors in the region; coordinates training programs throughout the region with the help of national banking supervisors and international agencies; and aims to help members develop banking laws, regulations, and supervisory practices that conform to international best practices. The Federal Reserve contributes significantly to ASBA's organizational management and to its training and technical assistance activities.

Initiatives for Minority-Owned and De Novo Depository Institutions

Partnership for Progress is a program created by the Federal Reserve to foster the strength and vitality of the nation's minority-owned and de novo depository institutions. Launched in 2008, the program seeks to help these institutions compete effectively in today's marketplace by offering a combination of one-on-one guidance and targeted workshops on topics of particular relevance to starting and growing a bank in a safe and sound manner.

Designated Partnership for Progress contacts in each of the 12 Reserve

Bank Districts and at the Board answer questions and coordinate assistance for institutions requesting guidance. These contacts also host regional conferences and conduct other outreach activities within their Districts in support of minority and de novo institutions. In 2009, the Reserve Banks hosted over 15 such regional training sessions, workshops, and conferences to provide assistance on key aspects of banking supervision. In December 2009, the staff met with select CEOs from these institutions to learn about their business challenges and opportunities and solicit inputs for improving Partnership for Progress.

Additionally, the Federal Reserve coordinates its efforts with those of the other agencies through participation in an annual interagency conference for minority depository institutions. For the federal banking agencies, the conference provides an opportunity to meet with senior managers from minority-owned institutions and gain a better understanding of the institutions' unique challenges and opportunities. Finally, the agencies offer training classes and breakout sessions on emerging banking issues.

Additional information on the Partnership for Progress can be found online at www.fedpartnership.gov/.

Supervisory Capital Assessment Program

The weak economic outlook entering 2009 contributed to uncertainty around the health and viability of U.S. financial institutions, jeopardizing the critical role banks play in lending to creditworthy households and businesses. With financial markets unwilling to provide capital to financial firms given this uncertainty, the Treasury worked with the Federal Reserve and the other federal banking agencies to initiate a supervisory exercise to assess whether major U.S. banking organizations needed an additional capital buffer, and to offer Treasury-contingent common equity to firms unable to raise the necessary capital through market issuance.

Beginning in February, the Federal Reserve led the effort to estimate potential losses—and resources available to absorb those losses—at 19 of the largest U.S. banking organizations, assuming an economic scenario more severe than was anticipated. This effort was designed to ensure that the firms would remain strongly capitalized and able to fulfill their function of providing credit to creditworthy borrowers. Termed the "Supervisory Capital Assessment Program," or "SCAP," this unprecedented effort involved over 150 examiners and analysts from across the Federal Reserve System and other federal banking agencies. Supervisors, economists, accountants, market specialists, and attorneys from the various agencies played a significant role in designing and executing the SCAP framework. The SCAP was unusually transparent for a supervisory exercise, as the Federal Reserve published a white paper detailing the methodology, process, and key economic assumptions underlying the analysis. The results were also published, with supervisors estimating total losses over 2009 and 2010 of $600 billion under the more adverse scenario.

In the aggregate, the 19 banking organizations were found to need $185 billion of capital, with the vast majority in the form of common equity, to establish the required capital buffer. The SCAP's emphasis on common equity reflects the fact that it is the first element of the capital structure to absorb losses, offers protection to more senior parts of the capital structure, and lowers the risk of insolvency. The 10 BHCs projected to have inadequate common stock under the stress test were required to submit a plan for raising such capital by early November. The Federal Reserve's identification of these organizations' capital needs, and its supervisory directive to these banking organizations to raise much-needed capital, helped restore confidence in the banking system and helped reopen the public equity markets to these institutions. In fact, the SCAP process, and related analysis of capital needed to support repayment of Treasury capital (led by the Federal Reserve), caused these 19 banking organizations to increase their tier 1 common capital by nearly $200 billion in 2009. These efforts have contributed to the recovery of nearly 70 percent of Treasury investments in the banking system.

The SCAP has served as a model for developing more effective and comprehensive supervision of the financial system. In the future, the Federal Reserve will increase its use of horizontal examinations and scenario analysis. As with the SCAP, these activities will involve multi-disciplinary perspectives, data-driven analysis to facilitate benchmarking across institutions, and expanded cooperation with primary and functional supervisors.

Supervisory Policy

In December, the Board approved a final rule amending the risk-based capital adequacy frameworks for state member banks and BHCs following changes to the U.S. generally accepted accounting principles from the Financial Accounting Standard Board's (FASB's) Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets, an Amendment of FASB Statement No. 140,* and Statement of Financial Accounting Standards 167, *Amendment to FASB Interpretation No. 46(R)* (FAS 166 and FAS 167). The final rule eliminates the exclusion of certain consolidated asset-backed commercial paper programs from risk-weighted assets; provides for a transitional phase-in of the effect on risk-weighted assets and tier 2 capital resulting from the implementation of FAS 166 and FAS 167; and adds a reservation of authority addressing off-balance sheet entities. The final rule was issued by the federal banking agencies in January 2010.

During the year, the Board, in some instances together with the other federal banking agencies, issued several rulemakings and guidance documents:

- The Board issued for comment proposed guidance designed to help ensure that incentive compensation policies at banking organizations do not encourage excessive risk taking and are consistent with the safety and soundness of the organization. The Board also announced two supervisory initiatives designed to spur and monitor progress towards safe and sound incentive compensation arrangements, to identify emerging best practices, and to advance the state of practice more generally in the industry. The Board's initiatives are consistent with the *Principles for Sound Compensation Practices* issued in April 2009 by the Financial Stability Board and with the associated implementation standards. Final guidance is expected to be issued in 2010.
- The Board issued guidance regarding BHCs' declaration and payment of dividends, capital redemptions, and capital repurchases in the context of their capital planning processes. The

guidance largely reiterates Board supervisory policies and guidance in light of recent market events and highlights expectations regarding when a BHC should inform and consult with the Federal Reserve in advance of taking capital-related actions that could raise safety-and-soundness concerns. In addition, the Board issued *Dividend Increases and Other Capital Distributions for the 19 Supervisory Capital Assessment Firms,* a temporary addendum to the guidance advising certain BHCs to consult with Federal Reserve staff before taking any actions that could result in a diminished capital base, including increasing dividends or redeeming or repurchasing capital instruments.

- The Board issued supervisory guidance for BHCs and state member banks subject to the market risk capital rule that emphasizes some of the rule's core requirements and provides additional information and clarification on certain technical aspects of the rule. The guidance emphasizes requirements around the application of the market risk capital rule to all positions covered by the rule; risk capture in market risk models and model backtesting; and banking organizations' independent reviews of their market risk-management and measurement systems.
- The federal banking agencies issued guidance to banking organizations on the appropriate risk weighting of California-registered warrants for risk-based capital purposes. The guidance also discussed risk-management considerations with respect to accepting these warrants.
- Recognizing the challenges faced by banking organizations in raising capital in the uncertain economic environment, the Board adopted a final rule that delays until March 31, 2011, the effective date of new limits on the inclusion of trust preferred securities and other restricted core capital elements in tier 1 capital.
- The federal banking agencies issued a final rule providing that mortgage loans modified under the Treasury's Home Affordable Mortgage Program will generally retain the risk weight appropriate to the mortgage loan prior to modification.
- The federal banking agencies, together with the FCA and the NCUA, issued jointly for comment proposed rules requiring mortgage loan originators who are employees of institutions regulated by these agencies to meet the registration requirements of the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (the S.A.F.E. Act). The S.A.F.E. Act requires these agencies to jointly develop and maintain a system for registering residential mortgage loan originators who are employees of certain regulated institutions, including national and state banks, savings associations, credit unions, and Farm Credit System institutions, and certain of their subsidiaries. A final rule is expected to be issued in 2010.

Capital Adequacy Standards

In 2009, Board and Reserve Bank staff conducted supervisory analyses of a large number of complex capital issuances, private capital investments, and novel transactions to determine their qualification for inclusion in regulatory capital and consistency with safety and soundness. Much of the work involved evaluating enhanced forms of trust preferred securities, mandatory convertible securities, perpetual preferred stock, and convertible perpetual preferred stock (mandatory and optionally convertible). Board and Reserve Bank analyses of these capital issuances focused on compliance with the qualifying standards for tier 1 capital under the Board's capital rules, as well as consistency with safety and soundness. Staff required banking organizations to make changes needed for instruments to satisfy these criteria. Much of such staff review during 2009 focused on large amounts of common stockholders' equity raised under the SCAP process discussed above, as well as other banking organizations' capital issuances.

Board staff also participated in the review of many applications for private capital investments by private equity firms and other private investors to invest in banking organizations, including banking organizations in severely impaired financial condition. The focus of the analyses of such capital investments is compliance with the Board's capital standards for inclusion in tier 1 capital, as well as consistency with safety and soundness to ensure that the terms of such private investments do not (1) impede prudent action by issuing banking organizations to address financial issues or (2) impair the Federal Reserve's ability to take appropriate supervisory action.

Board and Reserve Bank staff also reviewed a significant number of exchange transactions conducted for the purpose of increasing GAAP equity to determine consistency with safety and soundness. These exchange transactions generally involved the exchange of billions of dollars of trust preferred securities at a deep discount in exchange for common stock, thereby increasing the percentage of banking organizations' tier 1 capital comprised of common stock.

Board staff also continued in 2009 to work closely with the Treasury on the terms of the capital instruments issued by banking organizations under the Capital Purchase Program (CPP), initiated in 2008, and the Capital Assistance Program (CAP), initiated in 2009. The purpose of these programs was to buttress the financial strength of banking organizations and the overall banking and financial systems to enable them to withstand severe financial stresses during 2009. Board staff reviewed the terms of securities structured by the Treasury for issuance by banking organizations under the CPP and CAP to determine their qualification for inclusion in tier 1 capital and consistency with safety and soundness. The Board issued interim final and final rules authorizing the inclusion in BHCs' tier 1 capital of CPP and CAP securities issued by publicly traded banking organizations. The Board also issued an interim final rule allowing the inclusion in BHCs' tier 1 capital of TARP securities issued by S corporations and mutual banking organizations to the Treasury.

Other Policy Issues

In 2009, the Board evaluated the condition of banking organizations applying to participate in the Treasury's CPP, assessed the ongoing capital requirements of large banking organizations through the SCAP, and provided transparent guidelines regarding the capital requirements of banking organizations preparing applications to redeem the Treasury's capital investment in their firms. Among these activities during 2009 were the following:

- The Board issued with the federal banking agencies and Treasury a joint statement on the CAP that

described the SCAP, which assessed the amount and quality of capital of the largest banking organizations under challenging economic scenarios.
- The Board published a white paper on process and methodologies employed by federal banking agencies in capital assessment of large U.S. BHCs (SCAP).
- The Board, with Treasury, FDIC, and OCC, issued a joint statement on the CAP and SCAP and released the results of the assessments of the 19 largest BHCs.

Accounting Policy

The Federal Reserve strongly endorses sound corporate governance and effective accounting and auditing practices for all regulated financial institutions. Accordingly, the supervisory policy function is responsible for monitoring major domestic and international proposals, standards, and other developments affecting the banking industry in the areas of accounting, auditing, internal controls over financial reporting, financial disclosure, and supervisory financial reporting.

Federal Reserve staff members interact with key constituents in the accounting and auditing professions, including standard-setters, accounting firms, the financial services industry, accounting and financial sector trade groups, and other financial sector regulators. The Federal Reserve also participates in the Basel Committee's Accounting Task Force, which represents the Basel Committee at international meetings on accounting, auditing, and disclosure issues affecting global banking organizations. These efforts help inform our understanding of current domestic and international practices and proposed standards and the formulation of policy positions based on the potential impact of changes in standards or guidance (or other events) on the financial sector. As a consequence, Federal Reserve staff routinely provides informal input to standard-setters, as well as formal input through public comment letters on proposals, to ensure appropriate and transparent financial statement reporting.

During 2009, Federal Reserve staff participated in activities arising from global market conditions and in support of efforts related to financial stability. The financial crisis raised accounting and reporting challenges for the financial sector. Addressing these challenges was a priority for Federal Reserve staff members. Significant issues arising from stressed market conditions included accounting for financial instruments at fair value, accounting for impairment in securities and other financial instruments, and accounting for asset securitizations and other off-balance-sheet items. Staff members participated in a number of discussions with accounting and auditing standard-setters and provided commentary on a number of proposals relevant to the financial sector. For example, staff provided comment letters to the FASB on proposals related to the use of fair value when inactive markets and distressed transactions exist and the recognition and presentation of impairment on investment securities. Staff also contributed to the development of numerous comment letters related to accounting and auditing matters that were submitted to the International Accounting Standards Board (IASB) and the International Auditing and Assurance Standards Board through the Basel Committee.

With respect to the future of financial reporting, Federal Reserve staff provided a comment letter to the Securities and Exchange Commission (SEC) on a roadmap for potential use of International Financial Reporting Standards in the United States. This letter supported the long-term goal of a single set of high-quality global standards and also identified a few challenges that would need to be addressed before establishing a date for U.S. companies to utilize International Financial Reporting Standards. The Federal Reserve supported the efforts of the FASB and the IASB to continue toward the achievement of converged standards, which should help to improve comparability of financial reporting across national jurisdictions and promote more efficient capital allocation. The Federal Reserve was actively involved in monitoring standard-setting projects that affect convergence, particularly with regard to financial instrument accounting, off-balance-sheet accounting, fair-value measurements, and provisioning. Federal Reserve staff continued to stress the importance of effective financial reporting and global convergence of accounting standards through regular interactions with the FASB and the IASB.

Given the Federal Reserve's unique perspectives on the challenges facing financial institutions and our role in the financial markets, staff participated on the joint FASB and IASB Financial Crisis Advisory Group, which published in July its review of standard-setting activities following the global financial crisis. Federal Reserve staff also participated on the FASB's Valuation Resource Group, which was created to assist the FASB in matters involving valuation for financial reporting purposes.

The Federal Reserve issued supervisory guidance to financial institutions and supervisory staff on accounting matters as appropriate. In addition, Federal Reserve policy staff support the efforts of the Reserve Banks in financial institution supervisory activities related to financial accounting, auditing, reporting, and disclosure.

Compliance Risk Management

Bank Secrecy Act and Anti-Money-Laundering Compliance

In 2009, the Federal Reserve provided training for staff on risk-focusing and the use of the FFIEC minimum BSA/Anti-Money-Laundering (AML) examination procedures in conjunction with broader efforts to increase consistency and address industry concerns about regulatory burden. The Federal Reserve currently chairs the FFIEC BSA/AML working group, which is a forum for the discussion of all pending BSA policy and regulatory matters, and participates in the Treasury-led Bank Secrecy Act Advisory Group, which includes representatives of regulatory agencies, law enforcement, and the financial services industry and covers all aspects of the BSA. Beginning in 2009, the FFIEC BSA/AML working group meeting participation was expanded, on a quarterly basis, to include the SEC, the Commodity Futures Trading Commission, the Internal Revenue Service, and the Office of Foreign Assets Control (OFAC) in an effort to share and discuss information on BSA/AML examination procedures and general trends.

The Federal Reserve and other federal banking agencies continued during 2009 to regularly share examination findings and enforcement proceedings with the Financial Crimes Enforcement Network under the interagency memorandum of understanding (MOU) that was finalized in 2004, and with the

Treasury's Office of Foreign Assets Control under the interagency MOU that was finalized in 2006.

International Coordination on Sanctions, Anti-Money Laundering, and Counter-Terrorism Financing

The Federal Reserve participates in a number of international coordination initiatives related to sanctions, money laundering, and terrorism financing. For example, the Federal Reserve has a long-standing role in the U.S. delegation to the intergovernmental Financial Action Task Force and its working groups, contributing a banking supervisory perspective to formulation of international standards on these matters.

The Federal Reserve also continues to contribute to international efforts to promote transparency and address risks faced by financial institutions involved in international funds transfers. The Federal Reserve participates in a subcommittee of the Basel Committee that focuses on AML/counter-terrorism financing issues. In May 2009, the Basel Committee released a paper titled *Due Diligence and Transparency regarding Cover Payment Messages Related to Cross-Border Wire Transfers.* The Federal Reserve, together with the other U.S. federal banking supervisors, issued interagency guidance clarifying the supervisors' perspective on certain points in the Basel Committee paper, including expectations for intermediary banks on OFAC sanctions screening and transaction monitoring to comply with BSA/AML requirements.

Corporate Compliance

Federal Reserve staff conducted training and industry outreach to clarify supervisory expectations with respect to compliance risk management and to implement the Federal Reserve's 2008 guidance relating to firmwide compliance-risk management programs and oversight at large banking organizations with complex compliance profiles.

International Guidance on Supervisory Policies

As a member of the Basel Committee, the Federal Reserve participates in efforts to advance sound supervisory policies for internationally active banking organizations and to improve the stability of the international banking system. During 2009, the Federal Reserve participated in ongoing cooperative work on strategic responses to the financial markets crisis, initiatives to enhance and implement Basel II, and many other policies. The Federal Reserve contributed to supervisory policy recommendations, reports, and papers issued by the Basel Committee, which were generally aimed at improving the supervision of banking organizations' risk-management practices. Among these final papers, consultative papers, and other publications were the following:

Final papers:

- *Guidelines for computing capital for incremental risk in the trading book,* published in July (consultative paper previously issued in January)
- *Revisions to the Basel II market risk framework,* published in July (consultative paper previously issued in January)
- *Enhancements to the Basel II framework,* published in July (consultative paper previously issued in January)
- *Principles for sound stress testing practices and supervision,* published in May (consultative paper previously issued in January)

Consultative papers:

- *International framework for liquidity risk measurement, standards and monitoring,* published in December
- *Strengthening the resilience of the banking sector,* published in December

Other publications:

- *Loss given default floors*
- *Analysis of the trading book quantitative impact study*
- *Stocktaking on the use of credit ratings*
- *Findings on the interaction of market and credit risk*
- *Report on special purpose entities*
- *Report and recommendations of the Cross-border Bank Resolution Group*
- *Range of practices and issues in economic capital frameworks*

Joint Forum

In 2009, the Federal Reserve continued to participate in the Joint Forum—an international group of supervisors of the banking, securities, and insurance industries established to address varied issues crossing the traditional borders of these sectors, including the regulation of financial conglomerates. The Joint Forum operates under the aegis of the Basel Committee, the International Organization of Securities Commissions, and the International Association of Insurance Supervisors. National supervisors of these three sectors, who are members of the Joint Forum's founding organizations, jointly meet and work together to carry out the responsibilities of the Joint Forum.

During the year, the Federal Reserve contributed to the development of supervisory policy papers, reports, and recommendations that may be issued in the near future. The Joint Forum, through its founding organizations, issued a comprehensive report on the structure and use of special purpose vehicles, *Report on Special Purpose Vehicles,* published on September 28, 2009. On June 15, 2009, the Joint Forum also published a final paper, *Stocktaking on the Use of Credit Ratings.*

Credit Risk Management

The Federal Reserve works with the other federal banking agencies to develop guidance on the management of credit risk; to coordinate the assessment of regulated institutions' credit risk; and to ensure that institutions properly identify, measure, and manage credit risk.

Prudent Commercial Real Estate Loan Workouts

In October, the Federal Reserve, along with the other financial regulators of the FFIEC, issued a policy statement on *Prudent Commercial Real Estate Loan Workouts.* This statement was issued to update longstanding guidance regarding the classification and workout of CRE loans, especially in light of recent increases in loan workouts. The guidance promotes prudent CRE loan workouts at regulated financial institutions and instructs examiners to take a balanced and consistent approach in reviewing institutions' workout activities. Further, examiners were reminded that renewed or restructured loans to creditworthy borrowers on reasonable terms should not be subject to adverse classification solely because the value of the underlying collateral has declined.

As discussed in the statement, prudent workouts are often in the best interest of both the institution and the borrower. The Federal Reserve expects examiners to evaluate a regulated institution's loan workouts, considering a project's current and stabilized cash flows, debt service capacity, guarantor support, and other factors relevant to a borrower's ability and willingness to repay the debt. The statement sets forth the appropriate standards for evaluating the management practices, workout arrangements, credit classification, regulatory reporting, and accounting for CRE loan workouts. The statement includes examples of CRE loan workouts, illustrating an examiner's analytical process for credit classifications and assessment of an institution's accounting and reporting treatments for restructured loans.

Shared National Credit Program

In September, the Federal Reserve, FDIC, OCC, and Office of Thrift Supervision released summary results of the 2009 annual review of the Shared National Credit (SNC) Program. The agencies established the program in 1977 to promote an efficient and consistent review and classification of shared national credits. A SNC is any loan or formal loan commitment—and any asset, such as other real estate, stocks, notes, bonds, and debentures taken as debts previously contracted—extended to borrowers by a supervised institution, its subsidiaries, and affiliates. A SNC must have an original loan amount that aggregates to $20 million or more and either (1) is shared by three or more unaffiliated supervised institutions under a formal lending agreement or (2) a portion of which is sold to two or more unaffiliated supervised institutions, with the purchasing institutions assuming their pro rata share of the credit risk.

The 2009 SNC review was based on analyses of credit data as of December 31, 2008, provided by federally supervised institutions. The 2009 review found that the commitment volume of SNCs rose 3.3 percent over the 2008 review, to $2.9 trillion. However, the number of credits remained virtually unchanged. "Criticized" assets represented 22.3 percent of the SNC portfolio, compared with 13.4 percent in the 2008 review. Criticized assets were mainly associated with the media and telecom, utilities, finance and insurance, and oil and gas sectors. Within the "criticized" category, "special mention" (potentially weak) credits declined to $195 billion, accounting for 6.8 percent of the SNC portfolio, compared with 7.5 percent in the 2008 review; and "classified" credits (credits having well-defined weaknesses) rose to $447 billion from $163 billion, accounting for 15.5 percent of the SNC portfolio compared with 5.8 percent in the 2008 review. The rise in classified and criticized credits in part resulted from the deterioration in large, leveraged credits used to finance merger and acquisition activity over the past several years. The reasons for this decline in credit quality include reliance on overly optimistic projections, weak covenant protection, and borrower's inability to obtain new funding.

Underwriting standards in 2008 improved from prior years, with examiners identifying fewer loans with structurally weak underwriting characteristics compared to credits written in 2006 and 2007. However, the SNC portfolio contained loans with structurally weak underwriting characteristics that were committed before mid-2007 that contributed significantly to the increase in criticized assets.

Banks' Securities Activities

In 2009, the Federal Reserve provided examiner training on Regulation R, adopted jointly by the Board and the SEC in September 2007, with a compliance date of January 1, 2009, for most banks. Regulation R implemented certain key exceptions for banks from the definition of the term "broker" under section 3(a) (4) of the Securities Exchange Act of 1934, as amended by the Gramm-Leach-Bliley Act.

Regulatory Reports

The Federal Reserve's supervisory policy function is responsible for developing, coordinating, and implementing regulatory reporting requirements for various financial reporting forms filed by domestic and foreign financial institutions subject to Federal Reserve supervision. Federal Reserve staff members interact with other federal agencies and relevant state supervisors, including foreign bank supervisors as needed, to recommend and implement appropriate and timely revisions to the reporting forms and the attendant instructions.

Bank Holding Company Regulatory Reports

The Federal Reserve requires that U.S. BHCs periodically submit reports providing financial and structure information. The information is essential in supervising the companies and in formulating regulations and supervisory policies. It is also used in responding to requests from Congress and the public for information about BHCs and their nonbank subsidiaries. Foreign banking organizations also are required to periodically submit reports to the Federal Reserve.

Reports in the FR Y-9 series—FR Y-9C, FR Y-9LP, and FR Y-9SP—provide standardized financial statements for BHCs on both a consolidated and a parent-only basis. The reports are used to detect emerging financial problems, to review performance and conduct pre-inspection analysis, to monitor and evaluate risk profiles and capital adequacy, to evaluate proposals for BHC mergers and acquisitions, and to analyze a holding company's overall financial condition. Nonbank subsidiary reports—FR Y-11, FR 2314, FR Y-7N, and FR 2886b—help the Federal Reserve determine the condition of BHCs that are engaged in nonbank activities and also aid in monitoring the number, nature, and condition of the companies' nonbank subsidiaries. The FR Y-8 report provides information on transactions between an insured depository institution and its affiliates that are subject to section 23A of the Federal Reserve Act; it is used to monitor bank exposures to affiliates and to ensure banks' compliance with section 23A of the Federal Reserve Act. The FR Y-10 report provides data on changes in organization structure at domestic and foreign banking organizations. The FR Y-6 and FR Y-7 reports gather additional information on organization structure and shareholders from domestic banking organizations and foreign banking organizations, respectively; the information is used to monitor structure so as to determine compliance with provisions of the Bank Holding Company Act and Regulation Y and to assess the ability of a foreign banking organization to continue as a source of strength to its U.S. operations.

During 2009, a number of revisions to the FR Y-9C report were implemented, including (1) new data items and revisions to existing data items on trading assets and liabilities, (2) new data items associated with the Treasury CPP, (3) new data items and revisions to existing data items on regulatory capital requirements, (4) new data items and revisions to several data items applicable to noncontrolling (minority) interests in consolidated subsidiaries, (5) clarification of the definition of loans secured by real estate, (6) clarification of the instructions for reporting unused commitments, (7) exemptions from reporting certain existing data items for BHCs with less than $1 billion in total assets, (8) instructional guidance on quantifying misstatements, (9) new data items and deletion of existing items for holdings of collateralized debt obligations and other structured financial products, (10) new data items and revisions to existing data items for holdings of commercial mortgage-backed securities, (11) new data items and revisions to existing data items for unused commitments with an original maturity of one year or less to asset-backed commercial paper conduits, (12) new data items and revisions to existing data items for fair-value measurements by level for asset and liability categories reported at fair value on a recurring basis, (13) new data items for pledged loans and pledged trading assets, (14) new data items for collateral held against over-the-counter derivative exposures (for BHCs with $10 billion or more in total assets), (15) new data items and revisions and deletions of existing data items for investments in real estate ventures, and (16) new data items and revisions to existing data items for credit derivatives.

Also effective in March 2009, the Consolidated Report of Condition and Income for Edge and Agreement Corporations (FR 2886b) was revised to reduce the reporting frequency to annual for Edge Act and agreement corporations with total assets of $50 million or less; collect a new Schedule RC-D, Trading Assets and Liabilities, comparable to, but less detailed than, Schedule HC-D, Trading Assets and Liabilities, on the FR Y-9C report; and collect additional information on option contracts and other swaps.

In addition, effective March 2009, the FR Y-11, FR 2314, and FR Y-7N reports were revised to collect new information on assets held in trading accounts.

Effective June 2009, the FR Y-9SP was revised to also collect new data items associated with the Treasury's CPP, and the FR Y-8 was revised to require respondents to submit all reports electronically.

Effective December 2009, the FR Y-10 report was updated to reference the accounting standard (FAS 167) with respect to the exclusion of reporting of variable interest entities. In addition, the instructions for the FR Y-6 were modified to incorporate the extended deadline for completion of the annual audit for nonpublic companies as amended by part 363 of section 112 of the Federal Deposit Insurance Corporation Improvement Act, to include the reporting of warrants issued to the Treasury through the TARP CPP program when the warrants represent 5 percent or more of voting stock, and to elucidate the legal responsibilities of the person attesting to the validity of the report.

In 2009, the Federal Reserve proposed a number of revisions to the FR Y-9C for implementation in 2010. The proposed revisions include items to identify other-than-temporary impairment losses on debt securities; additional items for unused credit card lines and other unused commitments and a related additional item for other loans; reformatting of the schedule that collects information on quarterly averages; additional items for assets covered by FDIC loss-sharing agreements; and clarification of the instructions for unused commitments.

Commercial Bank Regulatory Financial Reports

As the federal supervisor of state member banks, the Federal Reserve, along with the other banking agencies through the FFIEC, requires banks to submit quarterly Call Reports. Call Reports are the primary source of data for the supervision and regulation of banks and the ongoing assessment of the overall soundness of the nation's banking system. Call Report data, which also serve as benchmarks for the financial information required by many other Federal Reserve regulatory financial reports, are widely used by state and local governments, state banking supervisors, the banking industry, securities analysts, and the academic community.

During 2009, the FFIEC implemented revisions to the Call Report to enhance the banking agencies' surveillance and supervision of individual banks and enhance their monitoring of the industry's condition and performance. The revisions included new items on (1) the date on which the bank's fiscal year ends; (2) real estate construction and development loans on which interest is capitalized; (3) holdings of commercial mortgage-backed securities and structured financial products, such as collateralized debt obligations; (4) fair value measurements for assets and liabilities reported at fair value on a recurring basis; (5) pledged loans and pledged trading assets; (6) collateral and counterparties associated with over-the-counter derivatives exposures; (7) credit derivatives; (8) remaining maturities of unsecured other borrowings and subordinated notes and debentures; (9) unused short-term commitments to asset-backed commercial paper conduits; (10) investments in real estate ventures; and (11) held-to-maturity and available-for-sale securities in domestic offices. In addition, revisions were made to (1) modify several data items relating to noncontrolling (minority) interests in consolidated subsidiaries; (2) provide for exemptions from reporting certain existing items by banks having less than $1 billion in total assets; (3) clarify the definition of the term "loan secured by real estate"; (4) provide guidance in the reporting instructions on quantifying misstatements in the Call Report; (5) eliminate the confidential treatment of data collected from trust institutions on fiduciary income, expenses, and losses; and (6) expand information collected on trust department activities.

In addition, during 2009, the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks (FFIEC 002) was revised. Effective in March, a number of items were eliminated from Schedule O—Other Data for Deposit Insurance Assessment. In June, additional space was provided in the USA Patriot Act Section 314(a) Anti-Money Laundering section to allow for the optional reporting of additional contact information. In September, revisions were made to Schedule O in response to the temporary increase in the deposit insurance limit from $100,000 to $250,000 that has been extended through December 31, 2013.

Also during 2009, the FFIEC proposed a number of revisions to the Call Report for implementation in 2010. The proposed revisions include items to identify other-than-temporary impairment losses on debt securities; additional items for unused credit card lines and other unused commitments and a related additional item for other loans; new items pertaining to reverse mortgages; an additional item on time deposits and revisions to reporting of brokered deposits; and additional items for assets covered by FDIC loss-sharing agreements. In addition, revisions were proposed to change the reporting frequency of the number of certain deposit accounts from annually to quarterly; eliminate an item for internal allocations of income and expense from foreign offices; clarify the instructions for unused commitments; and change the reporting frequency of loans to small businesses and small farms from annually to quarterly.

Supervisory Information Technology

Information technology supporting Federal Reserve supervisory activities is managed within the System Supervisory Information Technology (SSIT) function in the Board's Division of Banking Supervision and Regulation. SSIT works through assigned staff at the Board and the Reserve Banks, as well as through System committees, to ensure that key staff members throughout the System participate in identifying requirements and setting priorities for information technology initiatives.

In 2009, the SSIT function completed an update to the supervision function's IT strategic plan. In addition, the following strategic initiatives were initiated or completed: (1) with the other federal regulatory agencies, continued the phased implementation of the new SNC system; (2) implemented new tools to improve secure document exchange and work team collaboration; (3) developed an IT architecture blueprint and roadmap; (4) adopted a strategy to simplify application security; (5) identified and implemented improvements to make technology and data more accessible to staff working in the field; (6) broadened the use of business intelligence tools to integrate supervisory and management information systems that support both office-based and field staff; and (7) implemented a tool for comprehensively tracking exam findings Systemwide.

National Information Center

The NIC is the Federal Reserve's comprehensive repository for supervisory, financial, and banking-structure data. It is also the main repository for many supervisory documents. NIC includes (1) data on banking structure throughout the United States as well as foreign banking concerns; (2) the National Examination Desktop (NED), which enables supervisory personnel as well as federal and state banking authorities to access NIC data; (3) the Banking Organization National Desktop (BOND), an application that facilitates secure, real-time electronic information-sharing and collaboration among federal and state banking agencies for the supervision of banking organizations; and (4) the Central Document and Text Repository, which contains documents supporting the supervisory processes.

Within the NIC, the supporting systems have been modified over time to extend their useful lives and improve business workflow efficiency. During 2009, work continued on upgrading the entire NIC infrastructure to provide easier access to information, a consistent Federal Reserve enterprise information data repository, a comprehensive metadata repository, and uniform security across the Federal Reserve System. Comprehensive testing was performed and application developers throughout the System were briefed on upcoming changes. Implementation was extended to begin in April 2010 and is expected to continue throughout 2010 as System applications are transitioned to use the new infrastructure. Also during the year, numerous programming changes were made to NIC applications in support of business needs, primarily to ensure NIC information remains current with the changing needs based on the continuing changes with the financial and banking markets.

NIC support also includes supporting the Shared National Credit Modernization Project (SNC Mod). The SNC Program is an interagency program established in 1977 to provide periodic credit-risk assessments of the largest and most complex credit facilities owned or agented by federally supervised institutions. The SNC Mod is a multi-year, interagency, information technology effort led by the Federal Reserve to improve the efficiency and effectiveness of the IT systems that support the SNC Program. SNC Mod focuses on a complete rewrite of the current legacy systems to take advantage of modern technology to enhance and extend the system's capabilities. A significant milestone was reached in December 2009 when the project team implemented the second phase of SNC Mod. This phase of the project was primarily focused on improving the data collection and validation processes including (1) collection of additional data elements to further describe the credits; (2) collection of Basel II metrics at the credit level; (3) collection of SNC data from banks that are participants in syndicated loans; (4) ability to collect SNC data from some banks on a quarterly basis rather than annually; and (5) improvements in data quality and the data validation processes by providing immediate feedback to reporting banks regarding the quality of their reported data. This significantly improves the efficiency of the data collection process and improves the quality of the data.

Finally, the Federal Reserve participated in a number of technology-related initiatives supporting the supervision function as part of FFIEC task forces and subgroups.

Staff Development

The Federal Reserve's staff development program is responsible for the ongoing development of nearly 2,400 professional supervisory staff and ensuring that these staff have the skills necessary to meet supervisory responsibilities today and in the future. The Federal Reserve also provides course offerings to staff at state banking agencies. Training activities in 2009 are summarized in the table opposite.

Examiner Commissioning Program

The Examiner Commissioning Program (ECP) involves approximately 22 weeks of instruction. Individuals move through a combination of classroom offerings, self-paced assignments, and on-the-job training over a period of two to five years. Achievement is measured by two professionally validated proficiency examinations: the first proficiency exam is required of all ECP participants; the second proficiency exam is offered in two specialty areas—safety and soundness, and consumer affairs. A third specialty, in information technology, requires that individuals earn the Certified Information Systems Auditor certification offered by the

Training for Banking Supervision and Regulation, 2009

Course sponsor or type	Number of enrollments		Instructional time (approximate training days)[1]	Number of course offerings
	Federal Reserve personnel	State and federal banking agency personnel		
Federal Reserve System	2,322	369	730	146
FFIEC	501	266	260	65
The Options Institute[2]	16	6	3	1
Rapid Response™	9,968	1,393	10	73

1. Training days are approximate. System courses were calculated using five days as an average, with FFIEC courses calculated using four days as an average.

2. The Options Institute, an educational arm of the Chicago Board Options Exchange, provides a three-day seminar on the use of options in risk management.

Information Systems Audit Control Association. In 2009, 164 examiners passed the first proficiency exam and 98 passed the second proficiency exam (75 in safety and soundness and 23 in consumer affairs).

Continuing Professional Development

Other formal and informal learning opportunities are available to examiners, including other schools and programs offered within the System and FFIEC-sponsored schools. System programs are also available to state and federal banking agency personnel. The Rapid Response™ program, introduced in 2008, offers System and state personnel 60–90 minute teleconference presentations on emerging issues or urgent training needs associated with implementation or issuance of new laws, regulations, or guidance.

Regulation of the U.S. Banking Structure

The Federal Reserve administers five federal statutes that apply to BHCs, financial holding companies, member banks, and foreign banking organizations—the Bank Holding Company Act, the Bank Merger Act, the Change in Bank Control Act, the Federal Reserve Act, and the International Banking Act. In administering these statutes, the Federal Reserve acts on a variety of proposals that directly or indirectly affect the structure of the U.S. banking system at the local, regional, and national levels; the international operations of domestic banking organizations; or the U.S. banking operations of foreign banks. The proposals concern BHC formations and acquisitions, bank mergers, and other transactions involving bank or nonbank firms. In 2009, the Federal Reserve acted on 633 proposals representing 2,143 individual applications filed under the five statutes. As a result of the declining economic conditions, an increased number of these proposals involved banking organizations in less than satisfactory financial condition.

Bank Holding Company Act

Under the Bank Holding Company Act, a corporation or similar legal entity must obtain the Federal Reserve's approval before forming a BHC through the acquisition of one or more banks in the United States. Once formed, a BHC must receive Federal Reserve approval before acquiring or establishing additional banks. Also, BHCs generally may engage in only those nonbanking activities that the Board has previously determined to be closely related to banking under section 4(c)(8) of the Bank Holding Company Act. Depending on the circumstances, these activities may or may not require Federal Reserve approval in advance of their commencement.[8]

When reviewing a BHC application or notice that requires prior approval, the Federal Reserve may consider the financial and managerial resources of the applicant, the future prospects of both the applicant and the firm to be acquired, the convenience and needs of the community to be served, the potential public benefits, the competitive effects of the proposal, and the applicant's ability to make available to the Federal Reserve information deemed necessary to ensure compliance with applicable law. In the case of a foreign banking organization seeking to acquire control of a U.S. bank, the Federal Reserve also considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. In 2009, the Federal Reserve acted on 250 applications and notices filed by BHCs to acquire a bank or a nonbank firm, or to otherwise expand their activities, including proposals involving private equity firms.

A BHC may repurchase its own shares from its shareholders. When the company borrows money to buy the shares, the transaction increases the company's debt and decreases its equity. The Federal Reserve may object to stock repurchases by holding companies that fail to meet certain standards, including the Board's capital adequacy guidelines. In 2009, the Federal Reserve acted on one stock repurchase proposal by a BHC.

The Federal Reserve also reviews elections submitted by BHCs seeking financial holding company status under the authority granted by the Gramm-Leach-Bliley Act. Bank holding companies seeking financial holding company status must file a written declaration with the Federal Reserve. In 2009, 16 domestic financial holding company declarations and one foreign bank declaration were approved.

Bank Merger Act

The Bank Merger Act requires that all proposals involving the merger of insured depository institutions be acted on by the relevant federal banking agency. The Federal Reserve has primary jurisdiction if the institution surviving the merger is a state member bank. Before acting on a merger proposal, the Federal Reserve considers the financial and managerial resources of the applicant, the future prospects of the existing and combined organizations, the convenience and needs of the community(ies) to be served, and the competitive effects of the proposed merger. The Federal Reserve also must consider the views of the U.S. Department of Justice regarding the competitive aspects of any proposed bank merger involving unaffiliated insured depository institutions. In 2009, the Federal Reserve approved 61 merger applications under the act.

8. Since 1996, the act has provided an expedited prior notice procedure for certain permissible nonbank activities and for acquisitions of small banks and nonbank entities. Since that time the act has also permitted well-run bank holding companies that satisfy certain criteria to commence certain other nonbank activities on a de novo basis without first obtaining Federal Reserve approval.

Change in Bank Control Act

The Change in Bank Control Act requires individuals and certain other parties that seek control of a U.S. bank or BHC to obtain approval from the relevant federal banking agency before completing the transaction. The Federal Reserve is responsible for reviewing changes in the control of state member banks and BHCs. In its review, the Federal Reserve considers the financial position, competence, experience, and integrity of the acquiring person; the effect of the proposed change on the financial condition of the bank or BHC being acquired; the future prospects of the institution to be acquired; the effect of the proposed change on competition in any relevant market; the completeness of the information submitted by the acquiring person; and whether the proposed change would have an adverse effect on the Deposit Insurance Fund. A proposed transaction should not jeopardize the stability of the institution or the interests of depositors. During its review of a proposed transaction, the Federal Reserve may contact other regulatory or law enforcement agencies for information about relevant individuals. In 2009, the Federal Reserve approved 119 change in control notices related to state member banks and BHCs, including proposals involving private equity firms.

Federal Reserve Act

Under the Federal Reserve Act, a member bank may be required to seek Federal Reserve approval before expanding its operations domestically or internationally. State member banks must obtain Federal Reserve approval to establish domestic branches, and all member banks (including national banks) must obtain Federal Reserve approval to establish foreign branches. When reviewing proposals to establish domestic branches, the Federal Reserve considers, among other things, the scope and nature of the banking activities to be conducted. When reviewing proposals for foreign branches, the Federal Reserve considers, among other things, the condition of the bank and the bank's experience in international banking. In 2009, the Federal Reserve acted on new and merger-related branch proposals for 1,503 domestic branches and granted prior approval for the establishment of three new foreign branches.

State member banks must also obtain Federal Reserve approval to establish financial subsidiaries. These subsidiaries may engage in activities that are financial in nature or incidental to financial activities, including securities-related and insurance agency-related activities. In 2009, one financial subsidiary application was approved.

Overseas Investments by U.S. Banking Organizations

U.S. banking organizations may engage in a broad range of activities overseas. Many of the activities are conducted indirectly through Edge Act and agreement corporation subsidiaries. Although most foreign investments are made under general consent procedures that involve only after-the-fact notification to the Federal Reserve, large and other significant investments require prior approval. In 2009, the Federal Reserve approved 47 applications and notices for overseas investments by U.S. banking organizations, many of which represented investments through an Edge Act or agreement corporation.

International Banking Act

The International Banking Act, as amended by the Foreign Bank Supervision Enhancement Act of 1991, requires foreign banks to obtain Federal Reserve approval before establishing branches, agencies, commercial lending company subsidiaries, or representative offices in the United States.

In reviewing proposals, the Federal Reserve generally considers whether the foreign bank is subject to comprehensive supervision or regulation on a consolidated basis by its home-country supervisor. It also considers whether the home-country supervisor has consented to the establishment of the U.S. office; the financial condition and resources of the foreign bank and its existing U.S. operations; the managerial resources of the foreign bank; whether the home-country supervisor shares information regarding the operations of the foreign bank with other supervisory authorities; whether the foreign bank has provided adequate assurances that information concerning its operations and activities will be made available to the Federal Reserve, if deemed necessary to determine and enforce compliance with applicable law; whether the foreign bank has adopted and implemented procedures to combat money laundering and whether the home country of the foreign bank is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering; and the record of the foreign bank with respect to compliance with U.S. law. In 2009, the Federal Reserve approved seven applications by foreign banks to establish branches, agencies, or representative offices in the United States.

Public Notice of Federal Reserve Decisions

Certain decisions by the Federal Reserve that involve an acquisition by a BHC, a bank merger, a change in control, or the establishment of a new U.S. banking presence by a foreign bank are made known to the public by an order or an announcement. Orders state the decision, the essential facts of the application or notice, and the basis for the decision; announcements state only the decision. All orders and announcements are made public immediately; they are subsequently reported in the Board's weekly H.2 statistical release. The H.2 release also contains announcements of applications and notices received by the Federal Reserve upon which action has not yet been taken. For each pending application and notice, the related H.2 gives the deadline for comments. The Board's website (www.federalreserve.gov) provides information on orders and announcements as well as a guide for U.S. and foreign banking organizations that wish to submit applications or notices to the Federal Reserve.

Enforcement of Other Laws and Regulations

The Federal Reserve's enforcement responsibilities also extend to the disclosure of financial information by state member banks and the use of credit to purchase and carry securities.

Financial Disclosures by State Member Banks

State member banks that are not members of BHCs and that issue securities registered under the Securities Exchange Act of 1934 must disclose certain information of interest to investors, including annual and quarterly financial reports and proxy statements. By statute, the Board's financial disclosure rules must be substantially similar to those of the SEC. At the end of 2009, 14 state member banks were registered with the Board under the Securities Exchange Act.

Securities Credit

Under the Securities Exchange Act, the Board is responsible for regulating credit in certain transactions involving the purchasing or carrying of securities. The Board's Regulation T limits the amount of credit that may be provided by securities brokers and dealers when the credit is used to purchase debt and equity securities. The Board's Regulation U limits the amount of credit that may be provided by lenders other than brokers and dealers when the credit is used to purchase or carry publicly held equity securities if the loan is secured by those or other publicly held equity securities. The Board's Regulation X applies these credit limitations, or margin requirements, to certain borrowers and to certain credit extensions, such as credit obtained from foreign lenders by U.S. citizens.

Several regulatory agencies enforce the Board's securities credit regulations. The SEC, the Financial Industry Regulatory Authority (formed through the combination of the National Association of Securities Dealers and the regulation, enforcement, and arbitration functions of the New York Stock Exchange), and the Chicago Board Options Exchange examine brokers and dealers for compliance with Regulation T. With respect to compliance with Regulation U, the federal banking agencies examine banks under their respective jurisdictions; the FCA and the NCUA examine lenders under their respective jurisdictions; and the Federal Reserve examines other Regulation U lenders.

Federal Reserve Membership

At the end of 2009, 2,288 banks were members of the Federal Reserve System and were operating 57,663 branches. These banks accounted for 34 percent of all commercial banks in the United States and for 71 percent of all commercial banking offices. ■

Consumer and Community Affairs

The Board's Division of Consumer and Community Affairs (DCCA) has primary responsibility for carrying out the Board's consumer protection program. DCCA augments its dedicated expertise in consumer protection law, regulation, and policy with resources from other functions of the Board and the Federal Reserve System to write and interpret regulations, educate and inform consumers, and enforce laws and regulations for consumer financial products and services. Key elements of the division's program include

- rulemaking, utilizing a team of attorneys to write regulations that implement legislation, update regulations to respond to changes in the marketplace, design consumer-tested disclosures to provide consumers consistent and vital information on financial products, and prohibit unfair and deceptive acts and practices;
- supervision and enforcement of state member banks and bank holding companies and their nonbank affiliates to ensure that consumer protection rules are being followed;
- consumer complaint and inquiry processes to assist consumers in resolving grievances with their financial institutions and to answer their questions;
- consumer education to inform consumers about what they need to know when making decisions about their financial services options;
- research to understand the implications of policy on consumer financial markets;
- outreach to national and local government agencies, consumer and community groups, academia, and industry to gain a broad range of perspectives, and to inform policy decisions and effective practices; and
- support for national and local agencies and organizations that work to protect and promote community development and economic empowerment to historically underserved communities.

Rulemaking and Regulations

Credit Card Reform

In May 2009, the Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (the Credit Card Act) codified and expanded existing Federal Reserve regulations prohibiting unfair credit card practices. Among other things, the new rules ban harmful practices and require greater transparency in the disclosure of the terms and conditions of credit card accounts. Throughout 2009, the Federal Reserve worked to implement the Credit Card Act.

Consistent with the effective dates set by Congress in the legislation, the Federal Reserve's rulemakings to implement the Credit Card Act were divided into three stages. As discussed below, the Board has completed the first two stages of rulemaking. The third stage will be completed later in 2010.

Stage One

The first stage of the Board's implementation of the Credit Card Act includes provisions with an effective date of August 2009.[1]

45-Day Notice Requirement for Significant Changes

The new rules require creditors to provide written notice to consumers 45 days before increasing an annual percentage rate (APR) on, or making another significant change to the terms of, a credit card account. The notice requirement is triggered by increases in rates applicable to purchases, cash advances, and balance transfers. Creditors must also provide notice when changes are made to the terms that are required to be disclosed at account opening, including those terms that are most important to consumers and that can have a significant impact on the cost of credit for a consumer: key penalty fees, transaction fees, fees imposed for the issuance or availability of credit, any grace period, and the balance computation method.

Consumer's Right to Reject Rate Increase or Change in Terms

In addition to the advance notice, consumers must be informed of their right to reject the increase or change before it goes into effect. If a consumer rejects the increase or change, the creditor may not impose a fee or charge, treat the account as in default, or require immediate repayment of the balance on the account.

Periodic Statements Must Be Mailed 21 Days in Advance

The rules require creditors to mail or deliver periodic statements for credit cards at least 21 days before the payment due date and the expiration of any grace period. This requirement must be met before creditors can treat a consumer's payment as late or impose additional finance charges.

Stage Two

The second stage of the Board's implementation of the Credit Card Act includes provisions with an effective date of February 22, 2010.[2]

Restricting Rate Increases for Existing Balances

An increase in the interest rate that applies to existing balances on a credit card account can come as a costly surprise to consumers who relied on the rate in effect at the time they opened the account or used the account for transactions. Subject to certain exceptions, the new rules generally prohibit credit card issuers from increasing the rates and fees that apply to existing balances, including when an account is closed, when an account is acquired by another institution, and when the balance is transferred to another account issued by the same creditor. The exceptions include temporary rates that expire after a specified period, rates that vary with an index, and accounts that are more than 60 days delinquent.

---

1. See press release (July 15, 2009), www.federalreserve.gov/newsevents/press/bcreg/20090715a.htm.

2. See press release (January 12, 2010), www.federalreserve.gov/newsevents/press/bcreg/20100112a.htm.

Evaluation of Consumer's Ability to Pay

Under the new rules, credit card issuers are required to establish and maintain reasonable policies and procedures to consider a consumer's ability to make required minimum payments each billing cycle (based on the full credit line and including any mandatory fees) before opening a new credit card account or increasing the credit limit for an existing account. Reasonable policies and procedures include consideration of at least one of the following in assessing the consumer's ability to pay: (1) the consumer's ratio of debt to income; (2) the consumer's ratio of debt to assets; or (3) the income the consumer will have after paying existing debt obligations.

Age Restrictions

The rules also impose specific requirements for opening a credit card account or increasing the credit limit on an existing account when the consumer is under the age of 21. In particular, an issuer cannot issue a credit card to a consumer younger than 21 unless their application includes either: (1) information indicating that the underage consumer has independent ability to make the required minimum payments for the account, or (2) the signature of a cosigner over age 21 who has the ability to make those payments and who assumes joint liability for any debt on the account.

Rules for Marketing Credit Cards to Students

The rules also prohibit creditors from offering a college student any tangible items (such as t-shirts, gift cards, or magazine subscriptions) to induce the student to apply for a credit card or other open-end credit product if the offer is made on or near a college campus or at an event sponsored by a college. In addition, colleges must publicly disclose their agreements with credit card issuers for marketing credit cards, and card issuers must make annual reports to the Board regarding those agreements.

Restricting Over-the-Limit Fees

The rules generally require creditors to obtain a consumer's express election (or "opt in") to the payment of transactions that exceed the account's credit limit before the creditor may impose any fee for those transactions. Credit card issuers are also prohibited from imposing more than one over-the-limit fee per billing cycle and may not impose an over-the-limit fee for the same transaction in more than three consecutive billing cycles.

The rules also prohibit credit card issuers from

- assessing an over-the-limit fee because the issuer did not promptly replenish the consumer's available credit (such as after the consumer makes a payment);
- conditioning the amount of available credit on the consumer's consent to payment of over-the-limit transactions; and
- imposing an over-the-limit fee if the consumer's credit limit is exceeded solely because of accrued interest charges or fees on the account.

Additional Consumer Protections

The wide-ranging consumer protection regulations adopted by the Board also include

- Credit card issuers are required to establish procedures to ensure that the administrator of an estate can resolve the outstanding credit card balance of a deceased accountholder in a timely manner.
- Credit card issuers are required to allocate a consumer's payment in excess of the required minimum payment first to the balance with the highest rate.
- Credit card fees charged to a credit card account during the first year after account opening may not exceed 25 percent of the initial credit limit.
- Credit card issuers may not impose interest charges on balances for days in previous billing cycles as a result of the loss of a grace period (a practice sometimes referred to as "double-cycle billing"). Card issuers also are prohibited from imposing interest charges on the portion of the balance that has been repaid when a consumer pays some but not all of a balance prior to expiration of a grace period.
- Credit card issuers may not charge a fee for making a payment except for payments involving an expedited service by a service representative of the issuer.
- Credit card issuers must disclose on the periodic statement sent to consumers: (1) the amount of time and total cost (interest and principal) involved in paying the consumer's balance in full by making only the required minimum payments; and (2) the monthly payment amount required to pay off the consumer's balance in 36 months and the total cost (interest and principal) of repaying the balance in 36 months.

Overdraft Services and Gift Card Rules

Restrictions on Overdraft Fees

In November, the Board announced rules that prohibit financial institutions from charging consumers fees for paying overdrafts on automated teller machine (ATM) and one-time debit card transactions, unless a consumer opts in, or affirmatively consents, to overdraft services for these transactions.[3] Overdraft fees can be particularly costly in connection with debit card overdrafts because the dollar amount of the fee may considerably exceed the dollar amount of the overdraft.

Consumers often are enrolled in overdraft services automatically, without their express consent. Consumer testing by the Board indicated that many consumers are unaware that they can incur overdrafts for ATM or one-time debit transactions, believing instead that these transactions will be declined. In contrast, consumer testing by the Board showed that consumers generally want their checks and automated clearing house (ACH) transactions paid even if the payment results in an overdraft fee being assessed.

Opt-In Requirement

The Board's rules require institutions to provide consumers with the right to opt in, or affirmatively consent, to the institution's overdraft service for ATM and one-time debit card transactions. The notice of the opt-in right must be provided, and the consumer's affirmative consent obtained, before fees or

3. See press release (November 12, 2009), www.federalreserve.gov/newsevents/press/bcreg/20091112a.htm.

charges may be assessed on the consumer's account for paying such overdrafts. The opt-in requirement applies to both existing and new accounts.

Protections for Consumers Declining Overdraft Coverage

The rules prohibit institutions from conditioning the payment of overdrafts for checks, ACH transactions, or other types of transactions on the consumer consenting to the institution's payment of overdrafts for ATM and one-time debit card transactions. For consumers who do not consent to the institution's overdraft service for ATM and one-time debit card transactions, the rules require institutions to provide those consumers with account terms, conditions, and features that are otherwise identical to those they provide to consumers who do consent. The rules include a model form developed through consumer testing that institutions may use to satisfy the opt-in notice requirement.

The Board's overdraft rules are issued under the Electronic Fund Transfer Act and have an effective date of July 1, 2010.

Restrictions on Gift Card Fees and Expiration Dates

In November, the Board proposed rules that would restrict the fees and expiration dates that may apply to gift cards. The rules would protect consumers from certain unexpected costs and would require that gift card terms and conditions be clearly stated.[4]

The Board's proposed rules generally cover retail gift cards, which can be used to buy goods or services at a single merchant or affiliated group of merchants, and network-branded gift cards, which are redeemable at any merchant that accepts the card brand (such as Visa or MasterCard).

Dormancy, Inactivity, or Service Fees and Expiration Dates

The proposed rules would prohibit dormancy, inactivity, and service fees on gift cards unless: (1) there has been at least one year of inactivity on the gift card; (2) no more than one such fee is charged per month; and (3) the consumer is given clear and conspicuous disclosures about the fees on the card and before the card is purchased.

The proposed rules would also provide that expiration dates for funds underlying a gift card must be at least five years from the date the card was issued or the date when funds were last loaded onto the card. This information would have to be clearly and conspicuously disclosed on the card and before the card is purchased.

Additional Disclosure Requirements

The proposed rules also would require the disclosure of all other fees imposed in connection with a gift card. These disclosures would have to be provided on or with the card and prior to purchase. The proposed rules also would require the disclosure on the card of a toll-free telephone number and, if one is maintained, a website that a consumer may use to obtain fee information or replacement cards.

The Board's proposed rules would implement statutory requirements set forth in the Credit Card Act that become effective on August 22, 2010.

4. See press release (November 16, 2009), www.federalreserve.gov/newsevents/press/bcreg/20091116a.htm.

Mortgage and Home Equity Lending Reform

The Board proposed significant new rules designed to (1) improve the disclosures consumers receive in connection with closed-end mortgages and home-equity lines of credit (HELOCs) and (2) provide new consumer protections for all home-secured credit.[5] The Board also adopted new rules to implement provisions of 2009's Helping Families Save Their Homes Act and the Mortgage Disclosure Improvement Act of 2008 (MDIA).

To shop for and understand the cost of a home-secured loan, consumers must be able to identify and understand the key terms that determine whether a particular loan is appropriate for them. The Board, working with a consultant, conducted focus groups and one-on-one cognitive interviews with more than 180 consumers from nine metropolitan areas across the United States in order to understand consumers' key concerns when shopping for home-secured credit. The results of these sessions informed the Board's rulemaking, which aims to ensure that required disclosures are presented in clear, understandable language and formatting so as to provide consumers with essential information at the appropriate time in the loan process.

Providing Meaningful Disclosures about Mortgages

The Board proposed rules in July 2009 to make disclosures about closed-end mortgages more meaningful and useful to consumers by highlighting potentially risky loan features, such as adjustable rates, prepayment penalties, and negative amortization.

Specifically, the proposal would include several requirements:

- At application, lenders would have to provide consumers with a one-page list of key questions to ask about the loan being offered. The new disclosures are designed to answer those questions.
- The information consumers receive within three days after application would highlight risky mortgage features (such as possible payment increases or negative amortization).
- For adjustable-rate mortgages, lenders would be required to show consumers how their payments might change, including by illustrating the highest monthly amount the consumer might pay during the life of the loan.
- The computation of the APR would be revised to include most fees and settlement costs, making it a better measure of the total cost of the loan.
- Disclosures would show consumers in a simple graph how their loan's APR compares to the average rate offered to borrowers with excellent credit.
- In addition to the early disclosures provided at application, lenders would also be required to provide final disclosures to consumers at least three days before the loan closing.
- For adjustable-rate mortgages, lenders would have to notify consumers 60 days in advance of a change in their monthly payment. (Currently, notice may be given 25 days in advance.)
- Creditors would have to provide monthly statements to consumers with loans that have payment options that could result in negative amortization.

5. See press release (July 23, 2009), www.federalreserve.gov/newsevents/press/bcreg/20090723a.htm.

Early Disclosures for Mortgage Loans

In May 2009, the Board issued final rules revising the disclosure requirements for mortgage loans in order to ensure that consumers receive information about loan costs earlier in the mortgage process.[6] These new rules implement provisions of MDIA and were effective July 30, 2009.

The new rules expand on rules published by the Board in July 2008, which require, among other things, that a creditor give a consumer transaction-specific information about costs shortly after the consumer applies for a closed-end mortgage loan secured by the consumer's principal dwelling ("early disclosures"). These early disclosures must be provided before the consumer pays any fee other than a reasonable fee for obtaining the consumer's credit history. The May 2009 final rules apply these provisions to loans secured by a dwelling even when it is not the consumer's principal dwelling, such as a second home.

Moreover, these rules require that:

- Creditors must deliver or mail early disclosures at least seven business days before closing.
- If the APR contained in the early disclosures becomes inaccurate (for example, due to a change in loan terms), creditors must provide corrected disclosures to the consumer at least three business days before closing.
- The disclosures must inform the consumer that they are not obligated to complete the transaction simply because disclosures were provided or because the consumer has applied for a loan.

The new rules also permit a consumer to waive the waiting periods and expedite closing to address a personal financial emergency, such as foreclosure.

Anti-Steering Protections

Disclosures alone may not always be sufficient to protect consumers from unfair practices. For example, yield spread premiums, which are payments from a lender to a mortgage broker or loan officer (loan originator) based on the interest rate, can create incentives for mortgage loan originators to "steer" borrowers to riskier loans with higher rates for which the loan originators will receive greater compensation. Consumers generally are not aware of the mortgage broker's or loan officer's conflict of interest and cannot reasonably protect themselves against it. Yield spread premiums may provide some benefit to consumers who choose to pay a higher rate so that the lender will fund origination costs that would otherwise be paid by the consumer.

To prevent mortgage loan originators from steering consumers to more expensive loans, the Board proposed rules that would

- prohibit payments to a mortgage broker or a loan officer based on the loan's interest rate or other terms, and
- prohibit mortgage brokers or loan officers from steering consumers to a lender offering less favorable terms in order to increase their compensation.

6. See press release (May 8, 2009), www.federalreserve.gov/newsevents/press/bcreg/20090508a.htm.

Home Equity Lines of Credit (HELOCs)

In July 2009, the Board proposed rules to enhance consumer protections for HELOCs and improve the timing, content, and format of information that creditors provide to consumers at application and throughout the life of such accounts.

The proposed rules would require certain disclosures:

- At application, the lengthy, generic disclosure consumers currently receive would be replaced with a new one-page summary of the basic information and risks about HELOCs.
- Within three days after receiving a consumer's application for a HELOC, lenders would be required to provide disclosures specifically tailored to the actual credit terms for which the consumer qualifies. These disclosures would provide information about costs and risky mortgage features in a tabular format.
- At account opening, lenders would provide final disclosures in the same format, allowing consumers to more easily compare them with earlier disclosures.
- Throughout the life of the HELOC plan, lenders would provide enhanced periodic statements showing the total amount of interest and fees charged for the statement period and the year to date.

The proposed rules also would enhance certain consumer protections applicable to HELOCs:

- To the extent a lender can change any terms of a consumer's HELOC plan, the lender would have to notify the consumer 45 days in advance of the change. The proposal would also improve the form and content of these notices.
- Lenders could not terminate an account for delinquency until payment is more than 30 days late.
- When a consumer's credit line has been suspended or reduced, creditors would have to provide additional information about the reasons for the action and the consumer's right to request reinstatement.

Notifying Consumers When Mortgage Loans Are Sold or Transferred

One of the consumer protection provisions of the Helping Families Save Their Home Act aims to ensure that consumers know who owns their mortgage loan. Because mortgages may be sold and transferred several times, borrowers can face difficulties in determining who owns their loan and who to contact about their loan. The Helping Families Save Their Home Act, which was enacted in May 2009, requires a purchaser or assignee that acquires a mortgage loan to provide the required disclosures to consumers in writing within 30 days of acquiring the loan. Although the statutory provision became effective immediately upon enactment, in November 2009, the Board issued interim final rules which provide guidance for complying with the statute.[7]

Private Education Loan Rules

In 2009, the Board revised Truth in Lending Act rules for private education

7. See press release (November 16, 2009), www.federalreserve.gov/newsevents/press/bcreg/20091116b.htm.

loans—loans made to a consumer by a private lender in whole or in part for postsecondary educational expenses.[8] The Board's rules implement provisions of the Higher Education Opportunity Act (HEOA) and apply to loan applications received by creditors on or after February 14, 2010.

Improved Disclosure

To enhance disclosure about private education loans, the Board worked with a consultant to conduct one-on-one cognitive interviews with consumers in order to develop effective disclosures that consumers can use to understand the costs and features of these loans.

The rules specify disclosures that creditors must provide at three different times in the loan origination process: (1) with the loan application or solicitation, (2) when the loan is approved, and (3) after the consumer accepts the loan but at least three days before funds are disbursed.

Under the Board's rules, with applications and solicitations, creditors must provide consumers general information about loan rates, fees, and terms, including an example of the total cost of a loan based on the maximum interest rate the creditor can charge. The disclosure must also inform the consumer about the availability of federal student loans, their interest rates, and where the consumer can find additional information regarding those loans.

Creditors must also provide a set of transaction-specific disclosures when the loan is approved and at consummation. These disclosures must include specific information about the rate, fees, and other terms of the loan that are offered to the consumer. The creditor must disclose, for example, estimates of the total repayment amount based on both the current interest rate and the maximum interest rate that may be charged. The creditor must also disclose the monthly payment at the maximum rate of interest.

30-Day Period to Accept or Reject Loan

Under the Board's rules, a consumer has the right to accept the rates and terms offered at any time within 30 days after receiving the transaction-specific disclosure provided at approval.

Three-Day Right to Cancel

A creditor must provide additional disclosures after a consumer accepts a private education loan. A consumer has the right to cancel the loan without penalty for up to three business days after receipt of this disclosure and the loan funds may not be disbursed until the three-day period expires.

Prohibition on Co-Branding

The rules prohibit creditors from using an educational institution's name, logo, or mascot in its marketing materials to imply that the educational institution endorses the loans offered by the creditor, unless the creditor and educational institution have a preferred lender arrangement under which the educational institution issues a permissible endorsement of the creditor's loans.

---

8. See press release (July 30, 2009), www.federalreserve.gov/newsevents/press/bcreg/20090730a.htm.

Consumer Credit Reporting and Risk-Based Pricing Rules

Credit reports are used to determine whether, and on what terms, consumers may obtain credit and other important products and services, and are also widely used to determine a consumer's eligibility for employment, insurance, and rental housing. Therefore, it is essential that the substantive information included in those reports is accurate. In 2009, the Board worked with other federal financial agencies to implement provisions of the Fair and Accurate Credit Transactions Act, which amends the Fair Credit Reporting Act, to impose new responsibilities on credit information furnishers and allow consumers to play a more active role in ensuring the accuracy of their own credit reports.

Credit Reporting Rules

Accuracy of Information Reported to Credit Bureaus

In July, the Board collaborated with other federal financial regulatory agencies and the Federal Trade Commission to publish rules and guidelines promoting the accuracy and integrity of information furnished to credit bureaus and other consumer reporting agencies.[9]

The rules require entities that furnish consumer information to credit bureaus (furnishers) to establish and implement reasonable written policies and procedures to ensure the accuracy and integrity of the information that is reported about consumers. Furnishers' policies and procedures should address matters including recordkeeping, internal controls, staff training, oversight of third-party service providers, and periodic self-evaluations.

The rules also require furnishers to include the consumer's credit limit (if applicable) among the information provided to a credit bureau. The Board and other agencies also published an advance notice of proposed rulemaking seeking to identify additional consumer information that furnishers should be required to provide to credit bureaus.

Right to Submit Disputes Directly to Information Furnisher

Under the credit reporting rules, if a consumer believes his or her credit report includes inaccurate information, the consumer may submit a dispute directly to the furnisher of the information and the furnisher must investigate the dispute. If the furnisher's investigation reveals that the information reported to a credit bureau was inaccurate, the furnisher must promptly notify each credit bureau to which the inaccurate information was provided and provide corrected information. The rules become effective July 1, 2010.

Risk-Based Pricing Rules

In December, the Board, along with the Federal Trade Commission, announced rules requiring creditors to notify consumers when, based on the consumer's credit report, the creditor provides credit on less favorable terms than it provides to other consumers. For example, if a consumer, because of information in his or her credit report, receives a mortgage with an APR higher than that offered to a substantial proportion of other consumers by that creditor, such that the consumer's cost of credit is significantly higher, the creditor must

9. See press release (July 2, 2009), www.federalreserve.gov/newsevents/press/bcreg/20090702a.htm.

send the consumer a "risk-based pricing" notice.[10]

Risk-based pricing refers to the practice of setting or adjusting the price and other terms of credit offered or extended to a particular consumer to reflect the risk of nonpayment by that consumer. Information from a consumer's credit report is often used in evaluating the risk posed by the consumer.

The rules require that a notice include a statement that the terms offered to the consumer may be less favorable than the terms offered to consumers with better credit histories. The notice also must contain a statement informing the consumer that he or she may obtain a free copy of his or her credit report from the credit reporting agency identified by the creditor in the notice.

The rules give creditors the option of providing consumers with a free credit score and information about their credit score as an alternative to providing risk-based pricing notices. Creditors that use the credit score disclosure alternative generally must provide free credit scores to any consumer who applies for credit before the consumer becomes obligated for the credit. The rules become effective on January 1, 2011.

Information Privacy Rules

In November, the Board, along with seven other federal regulatory agencies, released a model privacy notice designed to make it easier for consumers to understand how financial institutions collect and share consumer information.[11]

The Board and other agencies developed the model privacy notice based on extensive consumer testing that involved approximately 1,000 consumers from five locations across the United States. Consumer testing confirmed the effectiveness of the model notice as compared with other privacy notices, including a form of notice commonly used by financial institutions.

To ensure that privacy information is provided to consumers in a form that is readable and understandable, the model privacy notice uses a standardized tabular format and presents information in a question-and-answer format. The rules specify the format, typeface, font size, and presentation to make it easy for consumers to find specific information on the form and compare information provided by various institutions. A financial institution that uses the model form obtains a "safe harbor" for compliance with the regulatory requirements for privacy notices.

The rule, which was issued under Regulation P, became effective on December 31, 2009.

Community Reinvestment Act Rules

In June, the Board, along with other federal financial regulators, proposed revisions to regulations under the Community Reinvestment Act (CRA) that would require the Board to consider low-cost education loans provided to low-income borrowers when assessing a bank's record of meeting community credit needs under the CRA. Under

10. See press release (December 22, 2009), www.federalreserve.gov/newsevents/press/bcreg/20091222b.htm.

11. See press release (November 17, 2009), www.federalreserve.gov/newsevents/press/bcreg/20091117a.htm.

current CRA regulations, education loans are considered consumer loans, which may not be evaluated as part of a CRA assessment in some cases. The proposed revision reflects statutory changes made to the CRA by the Higher Education Opportunity Act.[12]

The proposal would also incorporate into the CRA regulations statutory language allowing the Board to consider capital investments, loan participations, and other ventures undertaken in cooperation with minority- and women-owned financial institutions and low-income credit unions when assessing a bank's CRA record.

Oversight and Enforcement

The Board's Division of Consumer and Community Affairs supports and oversees supervisory policy and examination procedures for consumer protection and community reinvestment laws in the oversight of state-chartered, depository institutions, and foreign banking organizations that are members of the Federal Reserve System. In addition, the division oversees the efforts of the Reserve Banks to ensure that consumer protection laws and regulations are fully and fairly enforced. Division staff provide guidance and expertise to the Reserve Banks on consumer protection regulations, bank application analysis and processing, examination and enforcement techniques, examiner training, and emerging issues. The staff develop and update examination policies, procedures and guidelines, as well as review Reserve Bank supervisory reports, examination work products, and consumer complaint analyses. Staff members also participate in interagency activities that promote uniformity in examination principles and standards.

Examinations are the Federal Reserve's primary method of enforcing compliance with consumer protection laws and assessing the adequacy of risk management systems for consumer protection. During the 2009 reporting period, the Reserve Banks conducted 282 consumer compliance examinations of the System's 782 state member banks and one foreign banking organization.[13]

Community Reinvestment Act Compliance

The Community Reinvestment Act (CRA) requires that the Federal Reserve and other federal banking and thrift agencies encourage financial institutions to help meet the credit needs of the local communities in which they do business, consistent with safe and sound operations.[14] To carry out this mandate, the Federal Reserve

- examines state member banks to assess their compliance with the CRA;
- analyzes applications for mergers and acquisitions by state member

12. See press release (June 24, 2009), www.federalreserve.gov/newsevents/press/bcreg/20090624a.htm.

13. The foreign banking organizations examined by the Federal Reserve are organizations that operate under section 25 or 25A of the Federal Reserve Act (Edge Act and agreement corporations) and state-chartered commercial lending companies owned or controlled by foreign banks. These institutions are not subject to the Community Reinvestment Act and typically engage in relatively few activities covered by consumer protection laws.

14. Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision (OTS).

banks and bank holding companies in relation to CRA performance; and
- disseminates information on community development techniques to bankers and the public through community affairs offices at the Reserve Banks.

The Federal Reserve assesses and rates the CRA performance of state member banks in the course of examinations conducted by staff at the 12 Reserve Banks. During the 2009 reporting period, the Reserve Banks conducted CRA examinations of 229 banks: 40 were rated "Outstanding," 187 were rated "Satisfactory," and two were rated "Needs to Improve."[15]

In June 2009, the Federal Reserve and other federal banking and thrift regulatory agencies proposed two revisions to the CRA that would incorporate new statutory requirements into the CRA regulations.[16] The first revision would implement Section 1031 of the Higher Education Opportunity Act, which requires the agencies to consider low-cost education loans provided to low-income borrowers when assessing a financial institution's record of meeting community credit needs. The second revision would incorporate the CRA statutory language that allows the agencies to consider and take into account capital investments, loan participations, and other ventures between nonminority- and nonwomen-owned financial institutions and minority- and women-owned institutions and low-income credit unions.

15. The 2009 reporting period for examination data includes examinations with end dates between July 1, 2008, and June 30, 2009.

16. See press release (June 24, 2009), www.federalreserve.gov/newsevents/press/bcreg/20090624a.htm.

Mergers and Acquisitions in Relation to the CRA

During 2009, the Board considered and approved four banking merger applications:

- An application by Allied Irish Banks, p.l.c., Dublin, Ireland, and its subsidiary, M&T Bank Corporation, Buffalo, NY, to acquire Provident Bancshares Corporation, Baltimore, MD, was approved in May.
- An application by Morgan Stanley, New York, NY, to acquire 9.9 percent of Heritage Bank, N.A., New York, NY, was approved in June.
- An application by Morgan Stanley, New York, NY, to acquire 9.9 percent of Chinatrust Financial Holding Company, Ltd., Taipei, Taiwan, Republic of China, was approved in June.
- An application by Morgan Stanley, New York, NY, to acquire 9.9 percent of United Western Bancorp, Inc., Denver, CO, was approved in October.

(Two other protested applications were withdrawn by the applicants.)

Members of the public had the opportunity to submit comments on the applications; their comments raised various issues. Some comments referenced pricing information on residential mortgage loans and concerns that minority applicants were more likely than nonminority applicants to receive higher-priced mortgages. Other comments alleged that certain minority groups received preferential treatment in comparison to other minority groups; that lenders failed to make credit available to certain minority groups and to low- and moderate-income individuals and in low- and moderate-income geographies; that lenders deliberately omitted reporting race information about certain applicants, information that is required by the Home Mortgage Disclosure Act (HMDA); and that lenders had not fulfilled their CRA responsibilities. In addition, some commenters claimed that lenders engaged in high-cost predatory lending and less-than-satisfactory loan servicing activities that contributed to the current foreclosure crisis.

The Board also considered 51 applications with outstanding issues involving compliance with consumer protection statutes and regulations, including fair lending laws and the CRA; 34 of those applications were approved and 17 were withdrawn. The number of applications with CRA issues, consumer compliance issues, or both was somewhat lower in 2009 than in 2008, as was the total number of all applications received, due, in part, to the financial crisis in the banking industry. However, the applications reviewed contained significantly more complex fair lending concerns than in previous years.

Fair Lending Enforcement

The Federal Reserve is committed to ensuring that the institutions it supervises comply fully with the federal fair lending laws—the Equal Credit Opportunity Act (ECOA) and the Fair Housing Act. Fair lending reviews are conducted regularly within the supervisory cycle. Additionally, examiners may conduct fair lending reviews outside of the usual supervisory cycle, if warranted by fair lending risk. When examiners find evidence of potential discrimination, they work closely with the division's Fair Lending Enforcement Section, which brings additional legal and statistical expertise to the examination and ensures that fair lending laws are enforced consistently and rigorously throughout the Federal Reserve System.

The Federal Reserve enforces the ECOA and the provisions of the Fair Housing Act that apply to lending institutions. The ECOA prohibits creditors from discriminating against any applicant, in any aspect of a credit transaction, on the basis of race, color, religion, national origin, sex or marital status, or age. In addition, creditors may not discriminate against an applicant because the applicant receives income from a public assistance program or has exercised, in good faith, any right under the Consumer Credit Protection Act. The Fair Housing Act prohibits discrimination in residential real estate-related transactions, including the making and purchasing of mortgage loans, on the basis of race, color, religion, sex, handicap, familial status, or national origin.

Pursuant to the ECOA, if the Board has reason to believe that a creditor has engaged in a pattern or practice of discrimination in violation of the ECOA, the matter will be referred to the Department of Justice (DOJ). The DOJ reviews the referral and determines whether further investigation is warranted. A DOJ investigation may result in a public civil enforcement action or settlement or the DOJ may decide instead to return the matter to the Federal Reserve for administrative enforcement. When a matter is returned to the Federal Reserve, staff ensure that the institution takes all appropriate corrective action.

During 2009, the Board referred the following six matters to the DOJ:

- One referral involved redlining, or discrimination against potential borrowers based upon the racial composition of their neighborhoods, in violation of the ECOA and the Fair Housing Act. Based on an analysis of the bank's lending practices, its marketing, the location of its branches, and its delineated assessment area under the CRA, the Board determined that the bank avoided lending in minority neighborhoods.

- Two referrals involved discrimination in mortgage pricing, in violation of the ECOA and the Fair Housing Act. In one matter, the Board found that Hispanic and African-American borrowers paid higher annual percentage rates (APRs) and overages than non-Hispanic white borrowers. In another matter, the Board found that African-American borrowers paid higher APRs than non-Hispanic white borrowers. Legitimate pricing factors failed to explain the pricing disparities in either matter.
- Two referrals involved discrimination on the basis of marital status, in violation of the ECOA. One referral involved a bank's policy and practice of requiring spousal guarantees on commercial loans, in violation of Regulation B. In the other referral, an institution improperly required spousal signatures for its agricultural, consumer, and commercial loans, in violation of Regulation B.
- One referral involved discrimination on the basis of age, in violation of the ECOA. The lender offered customers over 50 years of age membership in a special club with preferential credit features, including a 25 basis point discount on non-mortgage loans. The ECOA generally prohibits creditors from considering age when evaluating creditworthiness, except that a creditor may consider the age of an applicant 62 years or older in the applicant's favor.

If a fair lending violation does not constitute a pattern or practice that is referred to the DOJ, the Federal Reserve acts on its own to ensure that the violation is remedied by the bank. Most lenders readily agree to correct fair lending violations. In fact, lenders often take corrective steps as soon as they become aware of a problem. Thus, the Federal Reserve generally uses informal supervisory tools (such as memoranda of understanding between the bank's board of directors and the Reserve Bank) or board resolutions to ensure that violations are corrected. If necessary to protect consumers, however, the Board can and does bring public enforcement actions.

Evaluating Pricing Discrimination Risk by Analyzing HMDA Data and Other Information

The two previously mentioned referrals involving mortgage-pricing discrimination resulted from a process of targeted pricing reviews that the Federal Reserve initiated when Home Mortgage Disclosure Act (HMDA) pricing data first became available in 2005. Board staff developed—and continues to refine—HMDA screens that identify institutions that may warrant further review on the basis of an analysis of HMDA pricing data. Because HMDA data lack many of the factors lenders routinely use to make credit decisions and set loan prices, such as information about a borrower's creditworthiness and loan-to-value ratios, HMDA data alone cannot be used to determine whether a lender discriminates. Thus, Board staff analyze HMDA data in conjunction with other supervisory information to evaluate a lender's risk for engaging in discrimination.

Using 2008 HMDA pricing data—the most recent year for which the data

Analyzing HMDA Data

Enacted by Congress in 1975, the Home Mortgage Disclosure Act (HMDA) requires most mortgage lenders located in metropolitan areas to collect data about their housing-related lending activity, report the data annually to the federal government, and make the data publicly available. Data reporting requirements have expanded in recent years to capture reporting lenders' pricing information for higher-priced consumer mortgage loans.

An article published in September 2009 by Federal Reserve staff in the Federal Reserve Bulletin uses 2008 HMDA data to describe the market for higher-priced loans and patterns of lending across loan products, borrowers, and neighborhoods of different races and incomes.[1] The analysis documents the sharp contraction in total home lending between 2007 and 2008 (about 31 percent), led by a steep reduction in conventional lending. The analysis also provides a detailed assessment of the dramatic growth between 2007 and 2008 in home lending backed by the Federal Housing Administration's (FHA) mortgage insurance program.

As in recent years, the 2008 HMDA data show that most reporting institutions originated few if any higher-priced loans in 2008: 53 percent of the lenders originated less than 10 higher-priced loans that year and 30 percent originated no higher-priced loans. Of the 8,388 home lenders reporting HMDA data, 947 made 100 or more higher-priced loans.

The HMDA data also show that the majority of all loan originations were not higher priced; in fact, owing in large part to the mortgage market turmoil that first showed signs of emerging in late 2006, the incidence of higher-priced lending fell from a high watermark of 29 percent in 2006 to 18 percent in 2007 and to 12 percent in 2008.

1. Robert B. Avery, Neil Bhutta, Kenneth P. Brevoort, Glenn B. Canner, and Christa N. Gibbs, "The 2008 HMDA Data: The Mortgage Market during a Turbulent Year," April 2010 (revises 2009 draft release, includes revised data), www.federalreserve.gov/pubs/bulletin/2010/pdf/hmda08final.pdf.

are publicly available—Federal Reserve examiners performed a pricing discrimination risk assessment for each institution that was identified through the HMDA screening process. These risk assessments incorporated not just the institution's HMDA data but also the strength of the institution's fair lending compliance program; past supervisory experience with the institution; consumer complaints against the institution; and the presence of fair lending risk factors, such as discretionary pricing. On the basis of these comprehensive assessments, Federal Reserve staff determined which institutions would receive a targeted pricing review. Depending on the examination schedule, the targeted pricing review could occur as part of the institution's next examination or outside the usual supervisory cycle.

Even if an institution is not identified through HMDA screening, examiners might still conclude that the institution is at risk for engaging in pricing discrimination and perform a pricing review. The Federal Reserve supervises many institutions that are not required to report data under HMDA. Also, many of the HMDA-reporting institutions supervised by the Federal Reserve originate few higher-priced loans and, therefore, report very little pricing data. For these institutions, examiners analyze other available information to assess pricing-discrimination risk and, when appropriate, perform a pricing

Analyzing HMDA Data—continued

Overall, the incidence of higher-priced lending fell notably because lenders were unwilling or unable to extend credit to borrowers perceived to entail higher risk. Also, the incidence of higher-priced lending in 2008 was affected by the general "flight to quality" that tended to increase loan prices relative to the yield on Treasury securities and cause some loans to fall above the price reporting threshold even though those same loans would not have crossed the threshold prior to the financial market turmoil.

The HMDA data show that the incidence of higher-price lending varies by product type: higher-risk loans, such as those for manufactured homes, show the greatest incidence of higher-priced lending (in 2008 more than two-thirds of these loans are higher priced); lower-risk loans, such as those for first-lien mortgages and junior-lien loans, have a much lower incidence of higher-priced lending. Only seven percent of first-lien conventional home purchase loans and 11 percent of comparable junior-lien loans were reported as higher-priced in 2008.

Also, the data indicate that the incidence of higher-priced lending varies greatly among borrowers of different races and ethnicities. In 2008, 17.1 percent of African-American borrowers and 15.4 percent of Hispanic borrowers received higher-priced first-lien conventional home purchase loans, compared with 6.5 percent of non-Hispanic white and 3.3 percent of Asian borrowers. A similar pattern is found among government-backed loans (those insured by the FHA or guaranteed by the Department of Veterans Affairs), but the differences across racial and ethnic groups are much smaller.

Because HMDA data lack information about credit risk and other legitimate pricing factors, HMDA data alone cannot determine whether the observed pricing disparities and market segmentation reflect discrimination. When analyzed in conjunction with other fair lending risk factors and supervisory information, however, the HMDA data can facilitate fair lending supervision and enforcement. (See "Fair Lending Enforcement" in this chapter.)

review. During a targeted pricing review, staff analyze additional information, including potential pricing factors that are not available in the HMDA data, to determine whether any pricing disparity by race or ethnicity is fully attributable to legitimate factors, or whether any portion of the pricing disparity may be attributable to illegal discrimination.

Monitoring Emerging Fair Lending Issues

During the past year, economic conditions have shown signs of improvement; however, certain trends in credit markets continue to pose fair lending risk, especially related to credit tightening and loan modification activities. Lenders remain cautious and continue to reevaluate their lending practices. Some policies to tighten credit standards may fall disproportionately on minorities and raise fair lending concerns. For example, some lenders have implemented tighter credit standards in specific geographic markets, or have otherwise limited lending activity in certain geographic areas. In addition, the rapid increase of loan modifications and other loss mitigation efforts threatens to outpace compliance management programs.

In response to these trends, the Federal Reserve continues to carefully monitor lenders' practices for potential fair lending violations. Additionally, the Federal Reserve, in conjunction with other Federal Financial Institutions Examination Council (FFIEC) agencies, revised the Interagency Fair Lending Examination Procedures to better protect consumers from discriminatory practices.[17] The updated procedures revise examination guidance for detecting pricing, steering, reverse redlining, and redlining violations. In accordance with these procedures, the Federal Reserve conducts examinations to (1) evaluate whether lenders' policies may violate fair lending laws by having an illegal disparate impact on minorities, and (2) identify steering, redlining, reverse redlining, and other fair lending violations.

Flood Insurance

The National Flood Insurance Act imposes certain requirements on loans secured by buildings or mobile homes located in, or to be located in, areas determined to have special flood hazards. Under the Federal Reserve's Regulation H, which implements the act, state member banks are generally prohibited from making, extending, increasing, or renewing any such loan unless the building or mobile home and any personal property securing the loan are covered by flood insurance for the term of the loan. The law requires the Board and other federal financial institution regulatory agencies to impose civil money penalties when they find a pattern or practice of violations of the regulation. The civil money penalties are payable to the Federal Emergency Management Agency (FEMA) for deposit into the National Flood Mitigation Fund.

During 2009, the Board imposed civil money penalties (CMPs) against seven state member banks. The dollar amount of the penalties, which were assessed via consent orders, totaled $221,205.

Coordination with Other Federal Banking Agencies

The member agencies of the FFIEC develop uniform examination principles, standards, procedures, and report formats. In 2009, the FFIEC issued the following work products:

- Interagency Examination Procedures for the Servicemembers Civil Relief Act (SCRA) – The procedures are used to determine institution compliance with SCRA, including provisions related to interest rate reduction to six percent for active duty servicemembers, foreclosure protection, and protection of servicemembers' rights with regard to suspension of life insurance premiums, taxes, and business obligations.[18]
- Interagency Questions and Answers Regarding Flood Insurance – The questions and answers supersede the 1997 questions and answers document, and it supplements other recent guidance and interpretations issued by the agencies and FEMA.[19]

---

17. The FFIEC member agencies are the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA).

18. Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2009/0902/caltr0902.htm.

19. Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2009/0903/caltr0903.htm.

- Interagency Fair Lending Examination Procedures (revised) – The revised examination procedures reflect significant changes in credit markets, credit products, and credit practices since the procedures were last updated. The procedures clarify examination procedures related to pricing, steering, redlining, broker activity, performing examinations with small sample sizes, and data accuracy.[20]
- Interagency Examination Procedures for Regulation Z (revised) – The revised examination procedures incorporate the 2008 amendments to Regulation Z. The amendments were designed to protect consumers in the mortgage market from unfair, abusive, or deceptive lending and servicing practices. Among other things, the changes apply protections to a newly defined category of "higher-priced mortgages" that includes virtually all closed-end subprime loans secured by a consumer's principal dwelling.[21]
- Interagency Examination Procedures for the Home Mortgage Disclosure Act (revised) – The revised examination procedures incorporate the 2008 amendments to Regulation C for reporting pricing information on higher-priced loans. The changes to Regulation C conformed the threshold for rate spread reporting to the definition of "higher-priced mortgage loans" included in 2008 amendments to Regulation Z.[22]
- Interagency Examination Procedures for the Real Estate Settlement Procedures Act (RESPA) (revised) – The revised examination procedures incorporate the changes to RESPA that HUD issued in its 2008 final RESPA reform rule (73 F.R. 68204), which included both technical and substantive changes to its Regulation X. The key technical changes provide streamlined mortgage servicing disclosure language, eliminate outdated escrow account provisions regarding the phase-in period, and permit an "average charge" to be listed on the Good Faith Estimate (GFE) and HUD-1/1A Settlement Statement. The key substantive changes include implementation of a standardized and binding GFE form and revised HUD-1/1A Settlement Statement.[23]
- Interagency Examination Procedures for Regulation DD (revised) – The revised examination procedures incorporate changes to Regulation DD that address depository institutions' disclosure practices related to overdrafts. The changes require institutions to disclose the aggregate dollar amounts charged for overdraft fees and returned item fees on a periodic statement and, for institutions that provide account balance information through an automated system, to provide a balance that does not include additional funds that may be made available to cover overdrafts.[24]

20. Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2009/0906/caltr0906.htm.

21. Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2009/0909/caltr0909.htm.

22. Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2009/0910/caltr0910.htm.

23. Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2009/0911/caltr0911.htm.

24. Federal Reserve Board, Banking Information and Regulation, Supervision, Consumer Affairs Letters, www.federalreserve.gov/boarddocs/caletters/2009/0914/caltr0914.htm.

Training for Bank Examiners

Ensuring that financial institutions comply with laws that protect consumers and encourage community reinvestment is an important part of the bank examination and supervision process. As the number and complexity of consumer financial transactions grow, training for the examiners who review the organizations under the Federal Reserve's supervisory responsibility becomes even more important.

The consumer compliance examiner training curriculum consists of six courses focused on various consumer protection laws, regulations, and examination concepts. In 2009, the Board held 11 training sessions for 158 System consumer compliance examiners and professional staff, 25 state examiners, and one examiner from another regulatory agency. Several courses use a combination of instructional methods: (1) specially developed computer-based instruction that includes interactive self-check exercises, and (2) classroom instruction focused on case studies.

To keep the course materials current, Board and Reserve Bank staff routinely review examiner training materials, updating subject matter and adding new elements as appropriate. Periodically, staff members conduct in-depth reviews of a course curriculum, including the course objectives, content, and presentation methods. During 2009, staff reviewed two curricula: the Consumer Affairs Risk-focused Examination Techniques course, which provides training on all major aspects of risk-focused supervision, including scoping and risk assessment, report writing, ratings, supervisory enforcement actions, and the Board's referral processes; and the Commercial Lending Essentials for Consumer Affairs course, which provides assistant examiners with the fundamentals of commercial lending.

Board and Reserve Bank staff members are charged with providing updates to the System's content mapping initiative. This mapping tool, which provides a detailed view of training content in each and every System course, allows staff to more quickly identify and revise course materials that may be affected by regulatory, legal, or other changes. This year, FedLearn skill level definitions were identified for each training objective for consumer compliance courses and were included in the content map.

In addition to providing core training for non-commissioned assistant examiners, the examiner curriculum emphasizes the importance of continuing professional development for all examiners. Opportunities for continuing development include special projects and assignments, self-study programs, rotational assignments, the opportunity to instruct at System schools, mentoring programs, and an annual senior examiner forum. For example, in response to an ever-changing regulatory environment, System staff conducted two real estate workshops for experienced examination staff. The focus of the workshops was the new and revised mortgage rules and the RESPA reform. In addition, in 2009 the System continued to offer Rapid Response sessions, a mass-training effort using multi-media to deliver training, focusing on 12 time-sensitive or emerging consumer compliance topics. These sessions were designed, developed, and presented to System staff within days or weeks of perceived need.

Agency Reports on Compliance with Consumer Protection Laws

The Board reports annually on compliance with consumer protection laws by entities supervised by federal agencies. This section summarizes data collected from the 12 Federal Reserve Banks, the FFIEC member agencies, and other federal enforcement agencies.[25]

Regulation B (Equal Credit Opportunity)

The FFIEC agencies reported that approximately 81 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation B, compared with 85 percent for the 2008 reporting period. The most frequently cited violations involved

- failure to provide notice of approval, counteroffer, or adverse action within 30 days after receiving a completed credit application;
- failure to provide a written notice of denial or other adverse action to a credit applicant, containing the specific reason for the adverse action, along with other required information;
- failure to collect information about applicants seeking credit primarily for the purchase or refinancing of a principal residence, including applicants' race, ethnicity, sex, marital status, and age, for government monitoring purposes; and
- improperly collecting information on applicants' race, color, religion, national origin, or sex when not permitted by the regulation.

The Office of Thrift Supervision (OTS) and the Office of the Comptroller of the Currency (OCC) each initiated one formal Regulation B-related public enforcement action during the reporting period, while the Federal Deposit Insurance Corporation (FDIC) initiated 13.[26] There were no other enforcement actions by FFIEC agencies. The Federal Trade Commission (FTC) filed a complaint against a mortgage company alleging that it violated Regulation B (and the FTC Act).

The other agencies that enforce the ECOA—the Farm Credit Administration (FCA), the Department of Transportation (DOT), the Securities and Exchange Commission (SEC), the Small Business Administration, and the Grain Inspection, Packers and Stockyards Administration of the Department of Agriculture—reported substantial compliance among the entities they supervise. The FCA's examination activities revealed that most Regulation B violations involved either: (1) creditors' failure to request or provide information for government monitoring purposes or (2) creditors providing inadequate statements of specific reasons for adverse actions. None of these agencies initiated formal enforcement actions relating to Regulation B during the reporting period.

25. Because the agencies use different methods to compile the data, the information presented here supports only general conclusions. The 2009 reporting period was July 1, 2008, through June 30, 2009.

26. Public enforcement actions are categorized by regulation throughout the report. Because some enforcement actions include violations of more than one regulation, the overall sum of actions derived from each regulation will be greater than the actual total number of enforcement actions initiated, which was 30.

Regulation E (Electronic Fund Transfers)

The FFIEC agencies reported that approximately 94 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation E, which is comparable with the 2008 reporting period. The most frequently cited violations involved failure to

- investigate and determine whether an error occurred and provide the results to the consumer within 10 business days of receiving a notice of error from a consumer;
- provisionally credit the consumer's account for the amount of an alleged error when an investigation into the alleged error cannot be completed within 10 business days;
- provide initial disclosures that contain required information, including limitations on the types of transfers permitted and error-resolution procedures, at the time a consumer contracts for an electronic fund transfer service; and
- provide a written explanation to the consumer when an investigation determines that no error or a different error has occurred.

The OCC initiated one formal Regulation E-related enforcement action during the reporting period, while the FDIC initiated five. There were no other enforcement actions by FFIEC agencies or the SEC. The FTC filed three actions against companies for violating Regulation E and settled two cases brought in 2008.

Regulation M (Consumer Leasing)

The FFIEC agencies reported that 100 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation M, compared with 99 percent for the 2008 reporting period. The FFIEC agencies did not issue any public enforcement actions specific to Regulation M during the period.

Regulation P (Privacy of Consumer Financial Information)

The FFIEC agencies reported that approximately 98 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation P, compared with 97 percent for the 2008 reporting period. The most frequently cited violations involved failure to

- provide a clear and conspicuous initial privacy notice to customers;
- provide customers with a clear and conspicuous annual notice reflecting the institution's privacy policies and practices; and
- disclose the institution's information sharing practices in initial, annual, and revised privacy notices.

The OCC initiated one formal Regulation P-related enforcement action during the reporting period, while the FDIC initiated five.[27] There were no other enforcement actions by FFIEC agencies.

Regulation Z (Truth in Lending)

The FFIEC agencies reported that 92 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation Z, compared with 81 percent for the 2008 re-

27. The FDIC's reported information in this area relates to Part 332—Privacy of Consumer Financial Information—of the agency's regulations and not Regulation P.

porting period. The most frequently cited violations involved

- failure to accurately disclose the finance charge in closed-end credit transactions;
- failure to accurately disclose the APR in a closed-end credit transaction;
- failure to disclose the fact that a creditor has or will acquire an interest in a property purchased as part of a transaction; and
- on certain residential mortgage transactions, failure to provide a good faith estimate of the required disclosures before consummation, or not later than three business days after receipt of a written loan application.

In addition, 182 banks supervised by the Federal Reserve, FDIC, OCC, and OTS were required, under the Interagency Enforcement Policy in Regulation Z, to reimburse a total of approximately $3.14 million to consumers for understating APRs or finance charges in their consumer loan disclosures.

The OTS and the OCC each initiated one formal Regulation Z-related enforcement action during the reporting period, while the FDIC had 12. There were no other enforcement actions by FFIEC agencies. The DOT continued to prosecute one air carrier for its alleged improper handling of credit card refund requests and other Federal Aviation Act violations. The FTC filed two settlements and issued three consent orders involving alleged violations of Regulation Z.

Regulation AA (Unfair or Deceptive Acts or Practices)

The FFIEC agencies reported that more than 99 percent of the institutions examined during the 2009 reporting period were in compliance with Regulation AA, which is comparable with the 2008 reporting period. The OTS initiated three formal Regulation AA-related enforcement actions, the OCC initiated one, and the FDIC initiated six during the reporting period. There were no other enforcement actions by FFIEC agencies.

Regulation CC (Availability of Funds and Collection of Checks)

The FFIEC agencies reported that 90 percent of institutions examined during the 2009 reporting period were in compliance with Regulation CC, compared with 89 percent for the 2008 reporting period. The most frequently cited violations involved failure to

- make available on the next business day the lesser of $100 or the aggregate amount of checks deposited that are not subject to next-day availability;
- follow procedures when invoking the exception for large-dollar deposits;
- provide required information when placing an exception hold on an account; and
- make funds deposited from local and certain other checks available for withdrawal within the times prescribed by the regulation.

The OCC initiated four formal Regulation CC-related enforcement actions during the reporting period, while the FDIC initiated six. There were no other enforcement actions by FFIEC agencies.

Regulation DD (Truth in Savings)

The FFIEC agencies reported that 87 percent of institutions examined during the 2009 reporting period were in compliance with Regulation DD, compared with 86 percent for the 2008 reporting period. The most frequently cited violations involved

- failure to provide account disclosures containing all required information;
- inappropriate use of the phrase "annual percentage yield" in an advertisement without providing required additional terms and conditions;
- failure to provide account disclosures clearly and conspicuously, in writing, and in a form that the consumer may keep; and
- failure to provide timely, subsequent disclosures before maturity of time accounts.

The OTS and the OCC each initiated one formal Regulation DD-related enforcement action during the reporting period, while the FDIC initiated nine. There were no other enforcement actions by FFIEC agencies.

Responding to Consumer Complaints and Inquiries

The Federal Reserve investigates complaints against state member banks and selected nonbank subsidiaries of bank holding companies, and forwards complaints against other creditors and businesses to the appropriate enforcement agency.[28] Each Reserve Bank investigates complaints against state member banks and selected nonbank subsidiaries in its District. The Federal Reserve also responds to consumer inquiries on a broad range of banking topics, including consumer protection questions.

In late 2007, the Federal Reserve established Federal Reserve Consumer Help (FRCH) to centralize the processing of consumer complaints and inquiries. In 2009, its second full year of operation, FRCH processed 53,904 cases. Of these cases, half (26,979) were inquiries and half (26,925) were complaints, with most cases received directly from consumers. Approximately three percent of cases were referred from other agencies.

While consumers can contact FRCH by telephone, fax, mail, e-mail, or online, most FRCH consumer contacts occurred by telephone (78 percent).

Complaints against State Member Banks and Selected Nonbank Subsidiaries of Bank Holding Companies about Regulated Practices, by Regulation/Act, 2009

Regulation / Act	Number
Regulation AA (Unfair or Deceptive Acts or Practices)	82
Regulation B (Equal Credit Opportunity)	49
Regulation BB (Community Reinvestment)	2
Regulation C (Home Mortgage Disclosure)	4
Regulation CC (Expedited Funds Availability)	265
Regulation D (Reserve Requirements)	8
Regulation DD (Truth in Savings)	283
Regulation E (Electronic Funds Transfers)	142
Regulation G (Disclosure / Reporting of CRA-Related Agreements)	1
Regulation H (National Flood Insurance Act / Insurance Sales)	13
Regulation M (Consumer Lending)	2
Regulation P (Privacy of Consumer Financial Information)	35
Regulation Q (Payment of Interest)	7
Regulation V (Fair and Accurate Credit Transactions)	6
Regulation Z (Truth in Lending)	508
Fair Credit Reporting Act	83
Fair Debt Collection Practices Act	52
Fair Housing Act	1
Home Ownership Counseling	1
HOPA (Homeowners Protection Act)	3
Real Estate Settlement Procedures Act	80
Right to Financial Privacy Act	11
Total	**1,638**

28. Effective September 14, 2009, CA Letter 09-08, www.federalreserve.gov/boarddocs/caletters/2009/0908/caltr0908.htm.

Complaints against State Member Banks and Selected Nonbank Subsidiaries of Bank Holding Companies about Regulated Practices, by Product Type, 2009

Subject of Complaint/ Product Type	All complaints		Complaints involving violations	
	Number	Percent	Number	Percent
Total	**1638**	**100**	**86**	**5**
Discrimination alleged				
Real estate loans	24	1.5	3	0.2
Other loans	7	0.4	0	0
Nondiscrimination complaints				
Checking accounts	561	34.2	38	2.3
Real estate loans	398	24.3	16	1
Credit cards	213	13	13	.8

Nevertheless, 40 percent (10,643) of complaint submissions were made online, and the online form page received nearly 395,000 visits during the year.

Consumer Complaints

Complaints against state member banks and selected nonbank subsidiaries of bank holding companies totaled 8,073 in 2009. Nearly 40 percent (3,151) of these complaints were closed without investigation pending the receipt of additional information from consumers. Of the remaining complaints, 67 percent (3,284) involved unregulated practices and 33 percent (1,638) involved regulated practices.

Complaints about Regulated Practices

The majority of regulated practice complaints concerned checking accounts (34 percent), real estate (26 percent), and credit cards (13 percent). The most common checking account complaints related to insufficient funds or overdraft charges and procedures (52 percent), funds availability not as expected (9 percent), disputed withdrawal of funds (7 percent), and forgery, fraud, embezzlement, or theft (7 percent). The most common real estate complaints by problem code related to: "credit – other rates, terms, and fees" (13 percent), payment errors and delays (12 percent), credit denied - other (10 percent), and escrow account problems (7 percent); complaints by product code related to: home-purchase loans (51 percent), home refinance and closed-end loans (23 percent), and home equity credit lines (19 percent).[29] The most common credit card complaints related to debt collection practices (12 percent), "other rates, terms, and fees" (10 percent), and billing error resolutions (10 percent).

Thirty-one regulated complaints alleging discrimination were received. Of these, 18 complaints (one percent of total regulated complaints) alleged discrimination on the basis of prohibited borrower traits or rights.[30] Fifty percent

29. Real estate loans include adjustable-rate mortgages; residential construction loans; open-end home equity lines of credit; home improvement loans; home purchase loans; home refinance/closed-end loans; and reverse mortgages.

30. Prohibited basis includes: race, color, religion, national origin, sex, marital status, age, applicant income derived from public assistance programs or applicant reliance on provisions of the Consumer Credit Protection Act.

of discrimination complaints were related to the age of the applicant or borrower. Thirty-three percent of discrimination complaints were related to the race, color, national origin, or ethnicity of the applicant or borrower. The most common violations where discrimination was alleged involved real estate loans and other loans.

In 75 percent of investigated complaints against state member banks and selected nonbank subsidiaries of bank holding companies, evidence revealed that banks or subsidiaries correctly handled the situation. Of the remaining 25 percent, ten percent are open cases that are in process, 5 percent were deemed violations of law, one percent was regarding general errors, and the remainder primarily involved factual disputes or litigated matters. The most common violations involved checking accounts, real estate loans, and credit cards.

Complaints About Unregulated Practices

As required by Section 18(f) of the Federal Trade Commission Act, the Board continued to monitor complaints about banking practices not subject to existing regulations, with a focus on instances of potential unfair or deceptive practices. In 2009, the Board received 3,304 complaints against state member banks and selected nonbank subsidiaries of bank holding companies that involved these unregulated practices. Most complaints were related to checking account activity (35 percent), real estate concerns (25 percent), and credit cards (9 percent). More specifically, consumers most frequently complained about issues involving insufficient funds or overdraft charges and procedures; credit card interest rates, terms, and fees; debt collection/foreclosures; depository forgery, fraud, embezzlement, or theft; and opening and closing deposit accounts.

Complaint Referrals

In 2009, the Federal Reserve forwarded 18,360 complaints against other banks and creditors to the appropriate regulatory agencies and government offices for investigation. To minimize the time required to re-route complaints to these agencies, referrals were transmitted electronically.

The Federal Reserve forwarded eight complaints to the Department of Housing and Urban Development (HUD) that alleged violations of the Fair Housing Act.[31] The Federal Reserve's investigation of these complaints revealed no evidence of illegal credit discrimination.

Consumer Inquiries

The Federal Reserve received 26,979 consumer inquiries in 2009, covering a wide range of topics. The top three consumer protection issues documented with specific codes were: adverse action notices received pursuant to the Equal Credit Opportunity Act (11 percent); pre-approved credit solicitations (7 percent); and depository forgery, fraud, embezzlement or theft (3 percent). Consumers were typically directed to other resources, including other federal agencies or written materials, to address their inquiries.

31. A memorandum of understanding between HUD and the federal bank regulatory agencies requires that complaints alleging a violation of the Fair Housing Act be forwarded to HUD.

Supporting Community Economic Development

The Board's Division of Consumer and Community Affairs (DCCA) works to promote community economic development and fair access to credit for low- and moderate-income communities and populations. As a decentralized function, the Community Affairs Offices (CAOs) at each of the 12 Reserve Banks design activities to respond to the specific needs of the communities they serve, with oversight from Board staff. The CAOs provide information and promote awareness of investment opportunities to financial institutions, government agencies, and organizations that serve low- and moderate-income communities and populations. Similarly, the Board's CAO promotes and coordinates Systemwide, high-priority efforts; in particular, Board community affairs staff focus on issues that have public policy implications.

Foreclosures and Neighborhood Stabilization

In 2009, issues related to high rates of foreclosure continued to dominate the System's community affairs agenda. While each Reserve Bank addressed the impact of foreclosure on low- and moderate-income communities—through programming tailored to the particular needs of communities in their Districts—the entire System coordinated resources, knowledge, and expertise related to mortgage markets to address the foreclosure problem through the Mortgage Outreach and Research Efforts (MORE) Initiative.[32]

The MORE initiative aims to enhance the System's response to the foreclosure crisis by improving understanding of the incidents and underlying causes of foreclosures, working to mitigate the impact of foreclosures on individual borrowers and communities, and enhancing the System's communication of important research and policy findings to consumers, financial institutions, community development practitioners, state and local governments, and federal policymakers.

As part of the MORE initiative, for example, the System is conducting a study of the uses of funds distributed under the Neighborhood Stabilization Program (NSP), which was established by HUD to stabilize communities that have suffered from foreclosures and abandonment. In 2009, the System solicited input from various local stakeholders, which will serve as the foundation of a report to be issued in the spring of 2010 to describe the uses of NSP funds and to identify best practices for future funding expenditures. In addition, the Board worked with the Federal Reserve Banks of Boston and Cleveland on a publication addressing issues related to the acquisition and disposition of real estate owned (REO), a class of property owned by a lender, typically a bank, after an unsuccessful sale at a foreclosure auction. In addition, the System's Foreclosure Toolkit, a web-based resource center for borrowers, housing counselors, and community development practitioners, was updated to provide links to new information on outreach programs and to allow for further customization at the District-level.

The Board also partnered with NeighborWorks America® (NWA) again in 2009 to continue to leverage the System's resources with those of

32. See Federal Reserve Board, Community Development, Mortgage Foreclosure Resources, www.federalreserve.gov/consumerinfo/foreclosure.htm.

CRA Did Not Cause the Subprime Mortgage Crisis

As the recent financial crisis unfolded, many theories emerged about its underlying causes, including some claims that the Community Reinvestment Act (CRA) encouraged commercial banks and savings institutions (banking institutions) to undertake high-risk mortgage lending.

The Board rebuts claims that the CRA lies at the root of the crisis by making the following points.

The language and enforcement of the CRA do not portend excessively risky lending by banks.

The CRA encourages banking institutions to extend credit to low- and moderate-income (LMI) neighborhoods and households within the framework of safe and sound operation. Moreover, the CRA does not stipulate minimum targets or even goals for the volume of loans, services, or investments banking institutions must provide. Finally, while subprime mortgage lending grew most significantly in the early to mid 2000's, the CRA rules and enforcement process have not changed substantively since 1995. These three considerations weaken the theoretical link between the CRA and the subprime mortgage boom and bust.

Only a small portion of subprime mortgage originations in 2005 and 2006 can reasonably be linked to the CRA.

Data collected under the Home Mortgage Disclosure Act in 2005 and 2006 also suggest a tenuous link between the CRA and subprime mortgage lending. First, institutions not covered by the CRA (independent nonbank institutions) accounted for about half of all higher-priced mortgage originations (a proxy for subprime originations). Second, about 60 percent of higher-priced originations went to middle- or higher-income borrowers or neighborhoods, populations not targeted by the CRA. Finally, and perhaps most tellingly, only six percent of all higher-priced mortgage originations were extended by CRA-regulated lenders (and their affiliates) to either lower-income borrowers or neighborhoods in the lenders' CRA assessment areas (the geographies that are the focus of CRA evaluations).

Mortgage defaults and foreclosures have been severe even in middle- and higher-income neighborhoods, areas that are not the focus of the CRA.

Analysis of data on non-prime mortgages (subprime and near-prime loans) from First American LoanPerformance (LP) finds that the 90-days-or-more delinquency rate (as of August 2008) for loans originated between January 2006 and April 2008 is very high across geographies regardless of income. Similarly, data from RealtyTrac on foreclosure filings between January 2006 and August 2008 indicate that about 70 percent of filings have taken place in middle- or higher-income neighborhoods, and filings have increased more sharply in middle- or higher-income areas than in the lower-income areas targeted by the CRA. It is important to note, however, that the LP and RealtyTrac data do not identify borrower income, tempering the conclusions one can draw from these data.

the NWA network to address community stabilization in the wake of the record number of foreclosures.[33] As part of the partnership, the Board cosponsored the Neighborhood Stabilization Symposium, a featured program at NWA's December 2009 Training Institute in Washington, D.C. Federal Reserve Board Governor Elizabeth Duke delivered opening remarks at the symposium, which featured discussions and presentations of strategies and best practices in neighborhood stabilization.[34] The symposium attracted an audience of approximately 400 local practitioners and policymakers.

In 2009, the Board also hosted a series of forums to address the availability of affordable rental housing. Topics addressed in the series included the particular problems of tenants that rent properties from owners in foreclosure, strategies for managing scattered site properties, policies designed to create rental property from REO inventories, financing of small multifamily properties, and strategies for reviving the market for Low Income Housing Tax Credits (LIHTCs). The Federal Reserve Bank of St. Louis partnered with the Board for the LIHTC forum and published a collection of policy papers featured at the forum.[35]

33. Federal Reserve Board, Community Development, Resources for Stabilizing Communities, www.federalreserve.gov/communitydev/stablecommunities.htm.

34. Federal Reserve Board, News and Events, Testimony and Speeches, December 9, 2009, "Keys to Successful Neighborhood Stabilization," www.federalreserve.gov/newsevents/speech/duke20091209a.htm.

35. Federal Reserve Board, Community Development, Innovative Ideas for Innovating the LIHTC Market, www.federalreserve.gov/communitydev/other20091110a1.pdf.

Other Community Development Initiatives

Beyond foreclosure and neighborhood stabilization issues, DCCA provided important policy leadership in several areas in 2009. The Federal Reserve Banks of Boston and San Francisco published *Revisiting the CRA: Perspectives on the Future of the Community Reinvestment Act,* a compendium of policy recommendations regarding the modernization of the Community Reinvestment Act. The Boston and San Francisco Banks, together with the Board, co-hosted a policy discussion that introduced the publication and attracted leaders from the financial services industry, community advocates, foundations, think tanks, and academic institutions.

In addition, the Federal Reserve Bank of San Francisco partnered with the Board and the Community Development Financial Institutions Fund to host a Community Development Finance Summit in Washington, D.C. The summit brought together leaders in community development finance and featured a robust discussion of strategies to respond to the economic crisis. The San Francisco Bank's Center for Community Development Finance published materials that served as the basis for the discussion entitled *The Economic Crisis and Community Development Finance: An Industry Assessment.*[36] The Federal Reserve Bank of Boston also partnered with the Board and the Aspen Institute to follow-up on a System initiative begun in 2004 to address the scale and sustainability of

36. Federal Reserve Bank of San Francisco, Community Development, Publications, Working Papers, www.frbsf.org/publications/community/wpapers/2009/wp2009-05.pdf.

Consumer Education and Outreach: Meeting Consumers Where They Are

In today's complex and ever-changing consumer financial services marketplace, it is critical that consumers know where they can go for reliable information to assist them in making financial choices, and be able to spot a scam or a deal that is "too good to be true." The Federal Reserve has a wealth of unbiased, research-based consumer information, and, throughout the year, DCCA engaged in innovative ways to expand its outreach to connect consumers with these resources.

In 2009, high foreclosure rates gave rise to concerns about new risks for vulnerable consumers in the mortgage marketplace. With concern about an increase in foreclosure-related scams, the Board was among the first federal banking agencies to reach out to consumers to warn them. Board staff conducted research to determine the most effective strategy for delivering short information pieces to the greatest number of people. Data indicates that consumers go to the movies even in a down economy, so the Board began running ads in movie theaters in April that focused on helping consumers avoid foreclosure scams:

> "Having trouble keeping up with your mortgage payments? Are you facing foreclosure? Don't be taken advantage of—it shouldn't hurt to get help. Go to FederalReserve.gov and click on *5 Tips for Avoiding Foreclosure Scams.*"

Messages on avoiding foreclosure and scams were later expanded, with ads running in theaters over Labor Day weekend.

The Board also alerted consumers to changes in laws and regulations that have increased consumer credit card protections. With sweeping new rules being implemented in 2009 and 2010 (see "Credit Card Reform" in this chapter), the Board wanted consumers to have information about their accounts and rights, so it ran additional movie ads over Thanksgiving weekend to encourage wise credit card usage, directing viewers to *5 Tips for Getting the Most from Your Credit Card.*"[1]

1. See Federal Reserve Board, Consumer Information, www.federalreserve.gov/consumerinfo/fivetips_creditcard.htm.

community organizations by hosting a forum on subsidies in community development.

In April, the System held the sixth biennial System Community Affairs Officer's Research Conference.[37] The conference, entitled *Innovative Financial Services for the Underserved: Opportunities and Outcomes,* explored the role, processes, and outcomes of innovation in financial services for low- and moderate-income consumers and underserved populations. Leading researchers presented original and objective research designed to inform innovative market and product development through a framework that addressed (1) individual consumer preferences and behaviors with respect to consumer finance products, (2) influences affecting market participation, such as financial education and institutional structures, (3) effects of mortgage products on performance and wealth creation, and (4) approaches for shaping market participation.

37. Federal Reserve Board, Community Development, Community Affairs Conferences, "Innovative Financial Services for the Underserved: Opportunities and Outcomes," www.kc.frb.org/carc2009/.

Consumer Education and Outreach:
Meeting Consumers Where They Are—continued

The Board also took steps to expand its Internet presence in order to provide consumers with easier access to information. In 2009, the Board began developing an interactive, user-friendly website that focused on new credit card rules released in early 2010.[2] The Board developed a similar consumer education webpage on new rules for overdraft protection products.[3]

DCCA developed other new, web-based consumer resources and updated existing materials. In the spring of 2009, a new interactive Credit Card Repayment Calculator was added to the Federal Reserve's website.[4] The calculator helps consumers estimate how long it will take to pay their credit card bills under different payment scenarios. This new tool complements other interactive calculators on the website, including calculators that focus on mortgages and mortgage refinancing. DCCA also expanded its popular *5 Tips* series, with new information on shopping for a mortgage.[5]

The Board is also accessible to consumers through Federal Reserve Consumer Help (FRCH), a consumer complaint website.[6] This site includes information about bank products and services and consumers' rights, as well as links to other useful websites that provide information about recognizing and reporting scams. In fact, nearly 100 scams were reported through FRCH in 2009 and were sent to the appropriate federal authorities for investigation and prosecution.

2. See Federal Reserve Board, Consumer Information, www.federalreserve.gov/creditcard.

3. See Federal Reserve Board, Consumer Information, www.federalreserve.gov/consumerinfo/wyntk_overdraft.htm.

4. See Federal Reserve Board, Consumer Information, www.federalreserve.gov/creditcardcalculator.

5. See Federal Reserve Board, Consumer Information, www.federalreserve.gov/consumerinfo/fivetips.htm.

6. See Federal Reserve Board, Consumer Information, www.federalreserveconsumerhelp.gov.

Meeting Data and Analysis Needs

The Federal Reserve made a concerted effort to address the data needs of community development practitioners in 2009. The Federal Reserve Bank of Philadelphia hosted a conference in June entitled *Understanding the Housing and Mortgage Markets: What Data Do We Have? What Data Do We Need?*[38] The conference brought together researchers and government officials responsible for data collection to discuss existing data available from federal, state, and local sources to monitor economic and housing conditions in low- and moderate-income neighborhoods, as well as the limitations of the data and efforts to improve the quality and availability of data to address community development needs.

In addition, several Reserve Banks developed survey instruments to monitor economic conditions in low- and moderate-income communities. For

38. Federal Reserve Bank of Philadelphia, Community Development, Community Development Events. 2009, "Understanding the Housing and Mortgage Markets: What Data Do We Have? What Data Do We Need?," www.phil.frb.org/community-development/events/understanding-housing-and-mortgage/data-workshop-final-agenda.pdf.

example, the Federal Reserve Bank of Kansas City developed the *LMI Survey,* a quarterly survey that measures the economic conditions of low- and moderate-income communities and the organizations that serve them.[39] The survey results are used to construct five indicators of economic conditions in low- and moderate-income communities and two indicators of the condition of organizations serving them. The *LMI Survey* is available on the Reserve Bank's website and provides a gauge for service providers, policymakers, and others to evaluate and respond to changes in the economic conditions for low- and moderate-income individuals.

Consumer Advisory Council

The Board's Consumer Advisory Council (the Council)—whose members represent consumer and community organizations, the financial services industry, academic institutions, and state agencies—advises the Board of Governors on matters of Board-administered laws and regulations as well as other consumer-related financial services issues. Council meetings, open to the public, were held in March, June, and October. For a list of members of the Council, see the "Federal Reserve System Organization" section in this report; also, visit the Board's website for transcripts of Council meetings.[40]

39. Federal Reserve Bank of Kansas City, Community Development, Research, *LMI Survey,* www.kc.frb.org/home/subwebnav.cfm?level=3&theID=11201&SubWeb=3.

40. The transcript from the March meeting is available at www.federalreserve.gov/aboutthefed/cac_20090326.pdf. The transcript from the June meeting is available at www.federalreserve.gov/aboutthefed/cac_20090618.pdf. The transcript from the October meeting is available at www.federalreserve.gov/aboutthefed/cac_20091022.pdf.

Among the significant topics of discussion for the Council in 2009 were

- the Credit Card Accountability Responsibility and Disclosure Act of 2009 (the Credit Card Act);
- proposed changes to Regulation Z regarding disclosures that consumers receive in connection with closed-end mortgages and home-equity lines of credit and amendments that would provide new consumer protections for home-secured credit;
- proposed rules regarding overdraft services;
- issues related to foreclosures; and
- strategies and challenges related to neighborhood stabilization.

The Credit Card Act

In the June and October meetings, the Council addressed certain provisions of the Credit Card Act amending the Truth in Lending Act (TILA) and proposed amendments to Regulation Z (Truth in Lending) to protect consumers who use credit cards from a number of potentially costly practices (see "Credit Card Reform").

The Credit Card Act prohibits creditors from opening a new credit card account or increasing the credit limit for an existing account unless the creditor considers the consumer's ability to make the required payments under the terms of the account. Industry representatives encouraged the Board to adopt a broad, flexible approach regarding issuers' evaluation of a consumer's ability to pay, stating that issuers should be permitted to use an array of factors in underwriting, including generic and custom credit scores as well as institutions' internal information that is statistically derived from their portfolios. Consumer representatives expressed concern about the ability of regulators to review and validate issuers' underwriting models and methodologies due to their proprietary nature and about the use of credit scores for underwriting rather than a holistic assessment of consumers' ability to repay their full potential indebtedness.

In response to the Board's proposed rules to implement the ability-to-pay provision, industry members expressed support for the proposed rule requiring consideration of existing obligations as well as income or assets in assessing consumers' ability to make the required minimum payments, but noted the challenge in obtaining income information for existing customers. They encouraged the Board to include payment history as an additional factor in the ability-to-pay analysis and to permit use of modeled income, based on empirically derived and statistically sound models, as a substitute for reported income. Consumer representatives cautioned that regulators should closely monitor such modeling. Industry representatives also supported the proposed rule requiring issuers to estimate minimum payments based on a consumer's utilization of the full credit line, but encouraged the Board to clarify that the analysis would take into account only the credit line offered by the particular issuer, not the full utilization of a consumer's other credit lines. A consumer representative expressed the view that issuers should consider the full utilization of all credit lines in determining ability to pay.

Regarding penalty fees associated with credit card accounts, consumer representatives expressed the view that any fees should be reasonably related to the cost incurred by the creditor as a result of the violation, as verified by empirical data; that basing fees on deterrence should also be supported empirically; and that the overall standards for penalty fees should be subject to rigorous validation. Industry representatives supported the adoption of a flexible set of criteria to consider in determining the reasonableness and proportionality of penalty fees and encouraged the inclusion of portfolio-based analysis and issuers' loss rates as factors in addition to those specifically listed in the statute.

For over-the-limit fees, consumer representatives urged the Board to ensure that issuers provide appropriate disclosures regarding the opt-in requirement for extensions of credit that exceed the account's credit limit and to require that consumers who do not opt in nevertheless receive the same account terms, conditions, and features provided to consumers who do opt in. A consumer representative encouraged the Board to prohibit the assessment of over-the-limit fees due to credit-line reductions. An industry representative stated that the opt-in requirement for the over-the-limit feature will help to regulate the reasonableness of that fee. A consumer representative expressed the view that the opt-in requirement for over-the-limit transactions and fees will foster consumer choice and competition in the marketplace, but urged regulators to monitor the ways in which issuers communicate the change to consumers. Industry representatives encouraged the Board to allow issuers to begin informing consumers in advance of the requirement's February 22, 2010, implementation date that creditors obtain a consumer's express consent before imposing over-the-limit fees.

Regarding the statutory requirement that issuers reevaluate interest rate increases that are based on the credit risk of the consumer, market conditions, or other factors, industry representatives encouraged the Board to adopt a broad set of criteria for issuers to consider in making such decisions. Consumer representatives expressed the view that issuers' rate-setting and repricing methodologies should be subject to rigorous scrutiny and validation by regulators.

Industry representatives generally pointed to the emergence of a new business model in the credit card industry as issuers adjust to the elimination of "back-end" risk-management tools such as repricing and turn to more stringent "front-end" underwriting and overall higher pricing.

Overdraft Services

At the March meeting, Council members discussed the Board's proposed amendments to Regulation E (Electronic Fund Transfer Act), which would provide consumers with certain choices relating to the use of overdraft services and the assessment of overdraft fees (see "Overdraft Services and Gift Card Rules"). The proposed rules would prohibit financial institutions from imposing a fee on a consumer's asset account for paying an overdraft for an ATM or one-time debit card transaction unless the consumer is given notice of the right to opt out of the institution's overdraft service, and the consumer does not opt out. As an alternative approach, the proposal would require a consumer's affirmative consent, or opt-in, before such overdrafts could be paid by the financial institution and a fee imposed on the consumer's account for the service.

Members commended the Board for its work on the proposed overdraft rules and incorporation of feedback from the Council in prior meetings. Several industry representatives expressed support for the opt-out approach, which they stated would allow consumers to retain control of their financial situation while averting potential operational disruptions at the point of sale and alleviating the burden on institutions to gain affirmative consent from existing account-holders. One member suggested that the Board adopt an opt-out approach for current accounts and an opt-in approach for new accounts as of a certain date. Industry representatives also supported the idea that financial institutions should be permitted to price differently those accounts that do not allow overdrafts for ATM withdrawals and one-time debit transactions, compared to accounts that allow the payment of such overdrafts.

A consumer representative stated that surveys show that consumers want a choice about whether overdrafts are paid for debit-card transactions and that consumers generally want the transaction to be declined. Consumer representatives generally supported the opt-in approach, which they stated would provide incentives for institutions to communicate clearly about overdraft services to their customers. They also expressed the view that institutions should not be permitted to alter the account terms, conditions, or features for consumers who do not opt in compared to those who do opt in. According to one consumer representative, if banks change their business models to move away from free checking accounts, any account fee should be uniform and applied to all account-holders. One member also urged the Board to adopt substantive protections regarding overdraft services, such as limiting the number of overdrafts a consumer could be charged for during a year.

Closed-End Mortgages and Home Equity Lines of Credit

In July 2009, the Board proposed changes to the disclosures that consumers receive in connection with closed-end mortgage loans and home equity lines of credit (HELOCs) with the goal of improving their content and format to make them more useful to consumers (see "Mortgage and Home Equity Lending Reform"). These disclosures are required by the Board's Regulation Z. Many of the changes are based on the consumer testing conducted in connection with the review of Regulation Z. Council members strongly commended the Board's work on the disclosures and the use of extensive consumer testing to inform the content and format of the disclosures. Several members urged the Board to do further testing regarding consumers' experiences with mortgage transactions.

For closed-end mortgages, the Board's proposal would revise the calculation of the finance charge and annual percentage rate (APR) so that they better capture most fees and costs paid by consumers in connection with the loan. Several industry representatives cautioned against including additional fees, such as third-party charges, in the APR because such a calculation could mean that more loans will exceed the high-cost threshold under federal and state laws. A consumer representative supported including all fees in the APR to make it a more useful number for consumers and suggested that fees should be amortized over a typical refinancing period or the actual term of the loan, whichever is shorter.

The Board's proposal would require the creditor to provide a "final" TILA disclosure that the consumer must receive at least three business days before consummation, even if nothing has changed since the early TILA disclosure was provided. The proposal sets out two alternative approaches to address changes to loan terms and settlement charges during the three-business-day waiting period: receiving a new disclosure (and new waiting period) if any changes occur, or only when the APR becomes inaccurate or a variable rate feature is added. Consumer representatives and an industry member endorsed a strict three-day rule requiring a new disclosure and waiting period, with no waivers permitted. Other industry representatives supported a more flexible approach, such as allowing consumers to waive the three-day standard so that the closing could take place, and setting a threshold, with a de minimis exception, for the type or amount of changes that would trigger a new disclosure and waiting period.

The Board's proposal would also amend Regulation Z to provide limits on compensation to mortgage brokers and to creditors' employees who originate loans, prohibiting certain payments to originators based on the loan's terms or conditions. Several industry representatives expressed the view that the rule should apply only to loan originators, not to institutions that function as mortgage brokers, such as credit unions, community banks, or mortgage broker businesses; they stated that a broader application of the rule would have the effect of diminishing competition. Consumer representatives supported the rule and its classifications according to function, opposing any exception for brokers. One member urged the Board to consider means to ensure that the rules regarding compensation are applied consistently to banks and non-banks. In response to the proposal's prohibition on directing, or "steering," consumers to transactions that are not in their best interest in order to increase the originator's compensation, both industry and consumer representatives urged the Board to set forth a clearer, bright-line rule for what would constitute steering. A consumer representative noted that there is less risk of steering when a consumer is presented with multiple loan options.

Regarding HELOCs, the Board's proposal would prohibit creditors from terminating an account for payment-related reasons unless the consumer has failed to make a required minimum periodic payment for more than 30 days after the due date for that payment. An industry member supported the 30-day timeframe, but a consumer representative urged the Board to adopt a 60-day delinquency timeframe, consistent with the new delinquency period in the credit card context. The Board's proposal also would establish a new safe harbor for suspensions and credit-limit reductions and would impose additional requirements regarding reinstating accounts that have been temporarily suspended or reduced. Some members noted the impact on small businesses when HELOCs are suspended or the credit limit is reduced. Consumer representatives expressed the view that there should be a clear appeals process regarding line suspensions or reductions and that the lender should bear the costs associated with reinstating accounts, especially if later analysis shows that the line should not have been changed. Industry representatives also supported an appeals process, but stated that consumers should bear some of the cost, which could be refunded if the appeal is successful. An industry representative supported the proposed 30-day timeframe for lenders to complete an investigation of a request for reinstatement, but encouraged clarification that the time period would be triggered when the lender receives complete information from the borrower.

Foreclosure Issues

In each of its meetings in 2009, the Council discussed loss-mitigation efforts for mortgages, including the Administration's Making Home Affordable Program, the performance of modified mortgages, and other issues related to foreclosures. Members generally agreed on the need for more comprehensive and detailed data collection about mortgage delinquencies, foreclosures, and real estate owned (REO) properties.

Regarding the federal Making Home Affordable mortgage modification program, consumer representatives expressed concern about the capacity of servicers to handle the volume of requests and associated documentation, as well as delays in moving borrowers from trial modifications to permanent modifications. They also stated that some foreclosures are being filed while the borrower is in the trial modification period. Industry representatives stated that the need to fully document and completely underwrite loan modifications under the federal program leads to longer processing timeframes and compliance challenges. They also expressed the view that, in the early stages of the federal modification program, servicers were hampered by a lack of detailed technical guidelines and little advance notice of changes to the program, specifically noting the need for definition around the net-present-value model.

Later in 2009, some members pointed to signs of progress in the federal modification program, such as the increasing number of trial modifications initiated and borrowers evaluated for trial modifications. Industry representatives stated that, while participating servicers have increased their staffing and resources to implement the modification program, they face strict compliance requirements regarding documentation, as well as operational challenges in adjusting to changes to the program. Members agreed on the need for uniform loss-mitigation processes and guidelines to increase efficiency and reduce confusion among servicers and borrowers. One member noted that while most borrowers with trial modifications are making their payments, some are not able to do so because of economic hardship, such as job loss. Members generally agreed that the federal program does not adequately address the situations of jobless borrowers or those who are underwater on their loans.

A consumer representative expressed concern about the lack of information provided to borrowers who are denied a loan modification and the absence of an appeals process for the federal program. Members commended the Board for its work on fair-lending issues, particularly in the context of loan modifications. A consumer representative also urged the Board to monitor fair-lending issues related to the maintenance and disposition of REO properties by lenders.

Members raised concerns about the increasing prevalence of for-profit foreclosure consultants and foreclosure scams and emphasized the need for enforcement against such entities and warnings to consumers about not paying up-front fees for counseling or modification services. A consumer representative urged the provision of more resources for legitimate counseling agencies and legal services organizations to help guide distressed borrowers through the modification process. Members cited examples of successful collaborations among lenders, servicers, and nonprofit groups to engage in direct outreach with borrowers.

Several consumer and industry representatives endorsed a focus on principal write-downs as a key way to achieve sustainable modifications, and some members also suggested greater use of short sales in cases where an affordable modification cannot be achieved. Several consumer representatives expressed support for judicial mortgage modifications in the bankruptcy context and court-mediated resolution programs as additional tools to deal with foreclosures. Industry representatives cautioned that judicial modifications should be a last resort and should have reasonable limitations, such as being permitted only for subprime loans, and that the primary focus should be on achieving affordable modified payments for borrowers. Consumer and industry representatives disagreed about the value of second liens and the appropriate treatment of those loans both in the federal modification program and in the safety-and-soundness context.

Neighborhood Stabilization

Throughout 2009, the Council discussed the effects of foreclosures on the surrounding community, particularly in areas where foreclosures are concentrated, and efforts such as the federal Neighborhood Stabilization Program (NSP) to address the challenges of stabilizing communities. Members noted the negative effects of REO and vacant properties on neighborhoods, such as increased vandalism and crime, and the impact on the decisionmaking process of other homeowners who are struggling to stay current on their mortgage. They expressed concern about banks not maintaining their REO properties or not completing foreclosure sales, leading to "toxic titles," and urged federal regulators to increase oversight of regulated institutions regarding these issues. One member urged lenders and servicers to be attentive to the valuation process in the sale of REO properties and the effects of their property-disposition activities on housing prices and to focus on selling REO properties to owner-occupants.

Members described challenges in the implementation of the Neighborhood Stabilization Program (NSP), such as a lack of government infrastructure in some communities for managing the influx of federal funds and the reimbursement feature of the program. They noted that, given the relatively short implementation timeframe for the NSP, many local governments have opted for less complicated projects such as land banks or closing-cost assistance, rather than more complex acquisition and rehabilitation efforts. They also pointed to some positive developments, such as the NSP's provision of technical assistance and a move toward collaborative efforts on the local level, often led by community development organizations. They expressed support for initiatives to capitalize community development financial institutions (CDFIs) and other community development groups that can play important roles in neighborhood revitalization. Members noted that the CDFI industry serves as a key funding source for small businesses and other economic development activities, particularly in low- and moderate-income communities.

One member noted that the National Community Stabilization Trust is working to provide tools to address the issues of neighborhood stabilization and vacant and abandoned properties, such as a clearinghouse for REO properties between servicers and communities. However, members also described the difficulties in working with local governments regarding acquisition of REO properties due to the lack of standard purchase agreements. Members noted that nonprofit groups face significant challenges in addressing REO issues, from holding troubled properties to finding credit-worthy homebuyers and managing scattered-site rental properties. Finally, one member urged that further guidance be provided regarding the implementation of the Protecting Tenants at Foreclosure Act of 2009.

Other Discussion Topics

At the March meeting, the Council addressed issues related to the availability and quality of credit, particularly for consumers and small businesses. Members discussed measures that aim to restore the flow of critically important credit as well as the current state of lending, including the types and quality of credit products and terms that are available to consumers.

An industry representative commented on the experience of credit card issuers, which face increased funding costs and a sharp increase in loan losses and are responding by repricing and cutting credit lines; he also noted that Congressional action is likely to impact the overall business model of the credit card industry and access to credit. One member stated that increased monthly payments and interest rates for credit cards can exacerbate the cyclical problems that consumers and the industry are facing; another member expressed concern that individual issuers' actions in terms of risk-based pricing for credit cards may work to increase systemic risk. Some members also noted that credit cards and home-equity lines of credit are key sources of capital for small businesses, which face difficulties when those sources of funding are cut off.

A consumer representative stated that some consumers are still being offered credit products that raise concerns, and an industry representative noted the need for quality products that will help bring people who have experienced foreclosures or bankruptcy during the crisis back into the conventional credit market. One member urged attention to potentially problematic credit products, such as tax refund anticipation loans and short-term loans from banks, which may become more appealing to cash-strapped borrowers who cannot access other forms of credit. One member pointed to the need for both access to credit and quality of credit and the difficulties faced by individuals who have thin or no credit files; the member urged the Federal Reserve to study options for generating alternative sources of credit data to analyze consumers who do not have a traditional credit file.

Members praised the Federal Reserve's steps to bolster the markets for securitized assets and recommended further attention to the markets for Small Business Administration loans and affordable multifamily financing through the Low Income Housing Tax Credit.

At the June meeting, Council members focused on the future of the Community Reinvestment Act (CRA), including possible changes in light of developments in the financial services industry. Members discussed the idea of extending the CRA beyond depository institutions, such as to non-bank affiliates of depository institutions or to other non-bank financial services providers, such as credit unions or insurance companies. Several members noted that non-depository institutions benefited from government interventions during the financial crisis and should be subject to the responsibilities of CRA in exchange for such benefits. Members also expressed support for expanding the CRA to cover financial services and products beyond lending. One member noted that over the years regulators have added products for which institutions can receive CRA credit, but that the process of measuring the impact of such products needs improvement. A consumer representative suggested that CRA coverage should be extended to members of federally protected classes, such as racial and ethnic groups, women, and persons with disabilities, to ensure fair lending and the availability of quality financial products and services for those individuals.

Several industry representatives noted that the CRA's original purpose focused on serving low- and moderate-income communities from which deposits were taken and cautioned that expanding the CRA, whether to include other products and institutions or to address fair-lending issues, could dilute that purpose and the regulation's impact. An industry representative also expressed concern about the burden of complying with the CRA, particularly for smaller institutions. Both consumer and industry members agreed that any reexamination of the CRA should include attention to the quality and sustainability of credit, not just the quantity of credit.

Also at the June meeting, members provided input on the Board's rulemaking regarding the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act). Some members expressed the view that loss-mitigation personnel should be exempt from the SAFE Act's licensing requirements. Several members supported applying the requirements to personnel who provide refinancings. One member encouraged the Board to adopt a "grandfathering" approach for existing originators and to set stricter requirements for education and testing for loan officers at regulated depository institutions. ■

Federal Reserve Banks

The Federal Reserve Banks provide "payment services" to depository and certain other institutions, distribute the nation's currency and coin to depository institutions, and serve as fiscal agents and depositories for the U.S government and other entities. The Reserve Banks also contribute to setting national monetary policy and supervision and regulation of banks and other financial entities operating in the United States (discussed in the preceding chapters of this report).

Developments in Federal Reserve Priced Services

Federal Reserve Banks provide a range of payment and related services to depository institutions, including collecting checks, operating an automated clearinghouse (ACH) service, transferring funds and securities, and providing a multilateral settlement service. The Reserve Banks charge fees for providing these "priced services."

The Monetary Control Act of 1980 requires that the Federal Reserve establish fees for priced services provided to depository institutions so as to recover, over the long run, all direct and indirect costs actually incurred as well as the imputed costs that would have been incurred—including financing costs, taxes, and certain other expenses—and the return on equity (profit) that would have been earned if a private business firm had provided the services.[1] The imputed costs and imputed profit are collectively referred to as the *private-sector adjustment factor* (PSAF).[2] Over the past 10 years, Reserve Banks have recovered 97.8 percent of their priced services costs, including the PSAF (see table, next page).[3]

1. Financial data reported throughout this chapter—including revenue, other income, costs, income before taxes, and net income—can be linked to the pro forma financial statements at the end of this chapter.

2. In addition to income taxes and the return on equity, the PSAF includes three other imputed costs: interest on debt, sales taxes, and an assessment for deposit insurance by the Federal Deposit Insurance Corporation (FDIC). Board of Governors assets and costs that are related to priced services are also allocated to priced services; in the pro forma financial statements at the end of this chapter, Board assets are part of long-term assets, and Board expenses are included in operating expenses.

On March, 31, 2009, the Board of Governors requested public comment on a proposal to replace the current correspondent bank model underlying the PSAF calculation with a model based on elements derived from publicly traded firms more broadly. The Board is currently analyzing further the proposed publicly traded firm model and an alternate model based on a peer group of publicly traded payments processors that was suggested by several commenters.

3. Effective December 31, 2006, the Reserve Banks implemented the Financial Accounting Standards Board's Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* [Accounting Standards Codification (ASC) Topic 715 (ASC 715), *Compensation-Retirement Benefits*], which has resulted in the recognition of a $478.3 million reduction in equity related to the priced services' benefit plans through 2009. Including this reduction in equity, which represents a decline in economic value, results in cost recovery of 93.0 percent for the 10-year period. For details on how implementing ASC 715 affected the pro forma financial statements, refer to notes 3 and 5 at the end of this chapter.

Priced Services Cost Recovery, 2000–2009

Millions of dollars except as noted

Year	Revenue from services[1]	Operating expenses and imputed costs[2]	Targeted return on equity[3]	Total costs	Cost recovery (percent)[4,5]
2000	922.8	818.2	98.4	916.6	100.7
2001	960.4	901.9	109.2	1,011.1	95.0
2002	918.3	891.7	92.5	984.3	93.3
2003	881.7	931.3	104.7	1,036.1	85.1
2004	914.6	842.6	112.4	955.0	95.8
2005	994.7	834.7	103.0	937.7	106.1
2006	1,031.2	875.5	72.0	947.5	108.8
2007	1,012.3	913.3	80.4	993.7	101.9
2008	873.8	820.4	66.5	886.9	98.5
2009	675.4	707.5	19.9	727.5	92.8
2000–2009	9,185.2	8,537.2	859.0	9,396.3	97.8

NOTE: Here and elsewhere in this chapter, components may not sum to totals or yield percentages shown because of rounding.

1. For the 10-year period, includes revenue from services of $8,600.9 million and other income and expense (net) of $584.3 million.

2. For the 10-year period, includes operating expenses of $8,113.8 million, imputed costs of $140.8 million, and imputed income taxes of $282.5 million.

3. For 2009, in light of uncertainty about the long-term effect that the payment of interest on reserve balances held by depository institutions at the Reserve Banks would have on the level of clearing balances, the PSAF has been adjusted to reflect the actual clearing balance levels maintained throughout 2009.

4. Revenue from services divided by total costs.

5. For the 10-year period, cost recovery is 93.0 percent, including the net reduction in equity related to ASC 715 reported by the priced services in 2009.

In 2009, Reserve Banks recovered 92.8 percent of total priced services costs of $727.5 million, including the PSAF.[4] Revenue from priced services amounted to $662.7 million, other income was $12.7 million, and costs were $707.5 million, resulting in a net loss to priced services of $32.1 million.[5] During the year, the Banks raised prices, reduced operating costs, and accelerated the consolidation of their check-processing infrastructure to improve their overall cost recovery. These efforts, however, were not sufficient to offset reduced net income on clearing balances and increased pension costs.

4. *Total cost* is the sum of operating expenses, imputed costs (interest on debt, interest on float, sales taxes, and the FDIC assessment), imputed income taxes, and the targeted return on equity.

5. *Other income* is revenue from investment of clearing balances net of earnings credits, an amount termed net income on clearing balances.

The Reserve Banks are engaged in a number of technology initiatives that will modernize their priced services processing platforms over the next several years. The Banks are developing and planning to implement a new end-to-end electronic check-processing system to improve the efficiency and reliability of their current check-processing operations. They also continued efforts to migrate the FedACH and Fedwire Funds services off a mainframe system and to a distributed environment.

Commercial Check-Collection Service

In 2009, Reserve Banks recovered 92.8 percent of the total costs of their commercial check-collection service, including the PSAF. The Banks' operating expenses and imputed costs totaled $514.6 million. Revenue from operations totaled $481.7 million and

Activity in Federal Reserve Priced Services, 2007–2009

Thousands of items

Service	2009	2008	2007	Percent change	
				2008 to 2009	2007 to 2008
Commercial check	8,584,929	9,545,424	10,001,289	–10.1	–4.6
Commercial ACH	9,966,260	10,040,388	9,363,429	–0.7	7.2
Fedwire funds transfer	127,357	134,220	137,555	–5.1	–2.4
National settlement	464	469	505	–1.1	7.2
Fedwire securities transfer	10,519	11,717	10,110	–10.2	15.9

NOTE: Activity in *commercial check* is the total number of commercial checks collected, including processed and fine-sort items; in *commercial ACH,* the total number of commercial items processed; in *Fedwire funds transfer* and *securities transfer,* the number of transactions originated online and offline; and in *national settlement,* the number of settlement entries processed.

other income totaled $9.2 million, resulting in a net loss of $23.7 million. Check-service fee revenue in 2009 decreased $123.5 million from 2008.[6]

Reserve Banks handled 8.6 billion checks in 2009, a decrease of 10.1 percent from 2008 (see table above). The decline in Reserve Bank check volume has been influenced by nationwide trends away from the use of checks and toward greater use of electronic payment methods.[7] By year-end 2009, 98.6 percent of Reserve Bank check deposits and 94.3 percent of Reserve Bank check presentments were being made through Check 21 products.[8]

The Reserve Banks continued the consolidation of their check-processing offices in 2009. Because of the rapid adoption of electronic check processing, the Banks were able to reduce their check-processing infrastructure more quickly than originally expected. By year-end 2009, the Banks were processing paper checks at two sites nationwide, down from 13 at year-end 2008. This reduction is part of the Reserve Banks' multiyear initiative, begun in 2003, to reduce the number of offices at which Banks process checks to meet their long-run cost-recovery requirement under the Monetary Control Act of 1980.

Commercial Automated Clearinghouse Services

In 2009, the Reserve Banks recovered 93.4 percent of the total costs of their commercial ACH services, including the PSAF. Reserve Bank operating expenses and imputed costs totaled $98.5 million.

Revenue from ACH operations totaled $92.9 million and other income totaled $1.8 million, resulting in a net loss of $3.8

6. In 2008, the Reserve Banks discontinued the transportation of commercial checks between their check-processing offices. As a result, in 2009, there were no costs or imputed revenues associated with the transportation of commercial checks between Reserve Bank check-processing offices.

7. The Federal Reserve System's retail payments research suggests that the number of checks written in the United States has been declining since the mid-1990s. For details, see Federal Reserve System, "The 2007 Federal Reserve Payments Study: Noncash Payment Trends in the United States, 2003-2006" (December 2007), www.frbservices.org/files/communications/pdf/research/2007_payments_study.pdf.

8. The Reserve Banks also offer non-Check 21 electronic-presentment products. In 2009, 1.3 percent of Reserve Banks' deposit volume was presented to paying banks using these products.

Check 21 — Five Years Later

The Check Clearing for the 21st Century Act (Check 21), which became effective on October 28, 2004, promised a modernization of the nation's largely paper-based check-clearing system. In the five years since, considerable progress has been made toward achieving the act's purpose of improving the overall efficiency of the nation's payments system by fostering innovation in the check-collection system.

When Check 21 was enacted, the nation's retail payments system was already undergoing a transformation driven by changes in technology, rules, and consumer and business preferences. Federal Reserve research had revealed that, in 2003, the number of electronic payments had surpassed the number of check payments for the first time. However, the modernization of the check-collection system was stymied by laws that let banks demand that original checks be presented for payment. The banking industry's extensive reliance on the physical movement of checks became apparent after the terrorist attacks of September 11, 2001, when air traffic came to a standstill resulting in delays in the clearing of many checks.

Check 21 addressed these issues indirectly by creating a new negotiable paper instrument, called a substitute check, that when properly prepared would be the legal equivalent of an original check. The law required banks that were either unable or unwilling to accept checks electronically to accept substitute checks in place of the originals. This statutory change, in turn, facilitated "check truncation," whereby banks could stop forwarding original checks for collection or return and apply check-imaging technology in a more robust fashion to achieve the efficiencies and cost savings associated with electronic check clearing.

The Federal Reserve Banks began offering Check 21 services as soon as the law became effective. Initially, the move toward electronic check clearing unfolded gradually as many banks tried to determine how best to apply the provisions of the new law. The use of the Reserve Banks' Check 21 services accelerated after banks developed their business strategies and made the investments necessary to support the exchange of check images. Banks

million. The Reserve Banks processed 10.0 billion commercial ACH transactions, a decrease of 0.7 percent from 2008. ACH volumes were down slightly because of lower growth rates in industry ACH volume, including checks converted at lockbox locations.

A new industry ACH format related to cross-border transactions, the International ACH Transaction (IAT) format, was introduced in 2009. To help depository institutions meet their compliance obligations for international ACH transactions, the Reserve Banks began offering an IAT report service. This service searches incoming files for a given processing day and, if any IAT items are found, it generates a report displaying all IAT items for a given business day.

Fedwire Funds and National Settlement Services

In 2009, Reserve Banks recovered 92.1 percent of the costs of their Fedwire Funds and National Settlement Services, including the PSAF. Reserve Bank operating expenses and imputed costs totaled $69.3 million in 2009. Revenue from these operations totaled $64.4 million, and other income amounted to $1.3 million, resulting in a net loss of $3.6 million.

Check 21—continued

initially focused on collecting checks electronically rather than receiving their check presentments electronically. As a result of the disparity in adoption rates on the collection and presentment sides, Federal Reserve Bank substitute check volume peaked in October 2007, at 13.9 million per day, which represented 34 percent of Reserve Bank presentment volume.

The extensive use of costly substitute checks by the Reserve Banks was a transitional phenomenon, however, as an increasing number of banks began accepting check presentments electronically. In December 2009, almost 99 percent of Reserve Bank check deposits were electronic while 94 percent of check presentments were electronic. The re-engineering of the process by which banks return checks has lagged that of the forward check collection. More recently, however, the use of Reserve Bank electronic check return products has begun to accelerate and, by December 2009, 91 percent of check returns were deposited electronically and almost 51 percent were delivered electronically.

The rapid decline in the use of paper checks has allowed the Reserve Banks to reduce their processing infrastructure for paper checks more quickly than originally expected. In 2003, the Banks processed checks at 45 offices nationwide; by early 2010, only one Reserve Bank office processed paper checks. This infrastructure consolidation has enabled the Banks to significantly reduce check-processing costs, including the costs to physically transport paper checks.

The transformation of the nation's check-clearing system has also benefited retail and institutional bank customers. The Reserve Banks' consolidation of check-processing sites has resulted in the reclassification of checks from nonlocal to local, reducing the maximum permissible hold periods for deposited checks under Regulation CC. Beginning in 2010, nonlocal checks, as a class, no longer exist. Some banks have also extended deposit cutoff hours at branches and ATMs, and have begun to offer their customers remote deposit capture services, which allow checks to be deposited electronically for collection.

Fedwire Funds Service

The Fedwire Funds Service allows participants to use their balances at Reserve Banks to transfer funds to other participants. In 2009, the number of Fedwire funds transfers originated by depository institutions decreased 5.1 percent from 2008, to approximately 127 million. The average daily value of Fedwire funds transfers in 2009 was $2.5 trillion.

In 2009, the Reserve Banks implemented an enhanced Fedwire Funds Service message format to include additional information about cover payments. Cover payments are bank-to-bank funds transfers used to fund or settle underlying customer payment obligations. This message format provides the space to include identifying information about originators and beneficiaries of transfers, improving payment transparency and assisting banks in risk management and transparency.

National Settlement Service

The National Settlement Service is a multilateral settlement system that allows participants in private-sector clearing arrangements to settle transactions using Federal Reserve balances.

In 2009, the service processed settlement files for 41 local and national private-sector arrangements. The Reserve Banks processed slightly more than 10,500 files that contained almost 464,000 settlement entries for these arrangements in 2009.

Fedwire Securities Service

In 2009, the Reserve Banks recovered 93.8 percent of the total costs of their Fedwire Securities Service, including the PSAF. The Banks' operating expenses and imputed costs for providing this service totaled $25.1 million in 2009. Revenue from the service totaled $23.7 million, and other income totaled $0.5 million, resulting in a net loss of $0.9 million.

The Fedwire Securities Service allows participants to transfer electronically to other participants in the service certain securities issued by the U.S. Treasury, federal government agencies, government-sponsored enterprises, and certain international organizations.[9] In 2009, the number of non-Treasury securities transfers processed via the service decreased 10.2 percent from 2008, to approximately 10.5 million.

Float

The Federal Reserve had daily average credit float of $1,976.4 million in 2009, compared with credit float of $1,193.4 million in 2008.[10]

Developments in Currency and Coin

The Federal Reserve Board issues the nation's currency (in the form of Federal Reserve notes), and the Federal Reserve Banks distribute currency and coin through depository institutions. The Reserve Banks also receive currency and coin from circulation through these institutions.

The Reserve Banks received 35.2 billion Federal Reserve notes from circulation in 2009, a 4.1 percent decrease from 2008, and made payments of 35.8 billion notes into circulation in 2009, a 5.1 percent decrease from 2008. Although Reserve Bank payments into circulation decreased to pre-financial-crisis levels, receipts from circulation decreased to a greater extent, likely because consumers typically hold more currency in times of economic uncertainty. The value of currency in circulation increased 4.1 percent in 2009, to $887.8 billion, following a significant increase in 2008. The Banks received 65.3 billion coins from circulation in 2009, a 1.4 percent increase from 2008, and they made payments of 68.9 billion coins into circulation, a 4.7 percent decrease from 2008.

Board staff worked with Treasury, the U.S. Secret Service, and the Reserve Banks' Currency Technology Office to develop a more-secure design for the $100 Federal Reserve note. The

9. The expenses, revenues, volumes, and fees reported here are for transfers of securities issued by federal government agencies, government-sponsored enterprises, and certain international organizations. Reserve Banks provide Treasury securities services in their role as the U.S. Treasury's fiscal agent. These services are not considered priced services. For details, see the "Treasury Securities Service" section later in this chapter.

10. Credit float occurs when the Reserve Banks present items for collection to the paying bank prior to providing credit to the depositing bank (debit float occurs when the Reserve Banks credit the depositing bank prior to presenting items for collection to the paying bank).

new design was unveiled on April 21, 2010.

The Reserve Banks continued implementing a program to extend the useful life of the System's BPS 3000 high-speed currency-processing machines. The program will replace the operating systems of the current equipment, which will help improve the Reserve Banks' processing efficiency. By year-end 2009, the Banks had upgraded 90 of 131 machines. They expect to complete the program in 2010.

Reserve Banks are in the early stages of developing a new cash automation platform that will facilitate control of the Banks' cash operations and improve their efficiency, provide an expansive and responsive management information reporting system with superior and flexible reporting tools, facilitate business continuity and contingency planning, and enhance the support provided to Reserve Bank customers and business partners. In 2009, the Banks refined the design for the new system.

Developments in Fiscal Agency and Government Depository Services

As fiscal agents and depositories for the federal government, the Federal Reserve Banks auction Treasury securities, process electronic and check payments for Treasury, collect funds owed to the federal government, maintain Treasury's bank account, and invest Treasury balances. The Reserve Banks also provide certain fiscal agency and depository services to other entities; these services are primarily related to book-entry securities.

Treasury and other entities fully reimbursed the Reserve Banks for the costs of providing fiscal agency and depository services. In 2009, reimbursable expenses amounted to $450.3 million, compared with $461.1 million in 2008 (see table, next page). Support for Treasury programs accounted for 93.8 percent of the cost, and support for other entities accounted for 6.2 percent. The Reserve Banks actively monitor program expenses, and they strive to contain these costs while providing the resources necessary to accomplish program objectives.

Treasury Securities Services

The Reserve Banks work closely with Treasury's Bureau of the Public Debt in support of the borrowing needs of the federal government. The Banks auction, issue, maintain, and redeem securities; provide customer service; and operate the automated systems supporting paper U.S. savings bonds and book-entry marketable Treasury securities (bills, notes, and bonds). Treasury securities services consist of retail securities programs (which primarily serve individual investors) and wholesale securities programs (which serve institutional customers).

Retail Securities Programs

The Reserve Banks continued to support Treasury's efforts to improve the quality and efficiency of securities services provided to retail customers. The Banks process paper U.S. savings bonds transactions and book-entry marketable Treasury securities transactions for securities held in Legacy Treasury Direct, Treasury's first application designed to support retail customers who purchase marketable Treasury securities. Reserve Bank operating expenses for the retail securities programs were $73.7 million in 2009, compared with $72.4 million in 2008. Although the Banks' staffing levels declined slightly

Expenses of the Federal Reserve Banks for Fiscal Agency and Depository Services, 2007–2009

Thousands of dollars

Agency and service	2009	2008	2007
DEPARTMENT OF THE TREASURY			
Bureau of the Public Debt			
Treasury retail securities	73,678.5	72,373.7	74,149.2
Treasury securities safekeeping and transfer	8,814.6	9,304.7	8,687.7
Treasury auction	30,215.8	37,071.6	41,372.0
Computer infrastructure development and support	2,333.2	4,463.7	3,558.7
Other services	1,375.0	909.9	724.5
Total	116,417.0	124,123.7	128,492.1
Financial Management Service			
Payment services	104,354.8	108,218.5	105,326.8
Collection services	37,967.5	49,179.7	50,738.1
Cash-management services	49,045.7	**48,676.4**	**44,742.7**
Computer infrastructure development and support	66,958.5	65,058.6	70,999.9
Other services	7,392.9	7,577.4	7,245.7
Total	265,719.3	**278,710.6**	**279,053.2**
Other Treasury			
Total	40,390.3	**27,017.2**	**19,609.6**
Total, Treasury	422,526.6	429,851.5	427,154.9
OTHER FISCAL PRINCIPALS			
Total, other agencies	27,757.9	31,292.3	31,031.1
Total reimbursable expenses	450,284.5	461,143.9	458,186.0

NOTE: Numbers in bold reflect restatements due to recategorization.

in response to lower activity levels, the associated costs savings were offset by other cost increases.

During the year, the Reserve Banks began working with the Bureau of the Public Debt on an initiative that will improve the quality, consistency, and efficiency of support provided to retail securities customers. Treasury's Retail E-Services initiative aims to lower costs while providing a high-quality customer service experience, providing more opportunities for customer self-service, and eliminating duplicative processes.

Consistent with the trend from previous years, both the Legacy Treasury Direct and paper savings bonds programs experienced volume declines in 2009. The Legacy Treasury Direct system held $49.9 billion (par value) of Treasury securities as of December 31, a 21.2 percent decrease from 2008. This decrease is attributable to fewer reinvestments of maturing securities, fewer purchases of new securities, and higher dollar values of outgoing securities transfers.

The Reserve Banks also printed and mailed more than 20 million savings bonds in 2009, an 11.4 percent decrease from 2008. The decline in Legacy Treasury Direct holdings and in the number of paper savings bonds printed and mailed aligns with the Bureau of the Public Debt's strategic goal to transition retail customers from these legacy products to Treasury's web-based Treasury Direct application, which supports investments in book-entry Treasury securities and electronic savings bonds.

Wholesale Securities Programs

The Reserve Banks also support wholesale securities programs through the sale, issuance, safekeeping, and transfer of marketable Treasury securities. In support of Treasury's strategic goal to finance government operations effectively at the lowest overall cost, the Banks worked to contain costs in the auction and book-entry securities services. Reserve Bank operating expenses in 2009 in support of Treasury securities auctions were $30.2 million, compared with $37.1 million in 2008. The decline in costs is attributable to lower staffing levels resulting from the implementation of the new Treasury auction application in April 2008. In 2009, the Banks conducted 283 Treasury securities auctions, compared with 263 in 2008. The increase in the number of auctions was attributable in part to the reintroduction of the seven-year Treasury note, which is auctioned monthly.

In addition, operating expenses associated with securities safekeeping and transfer activities were $8.8 million in 2009, compared with $9.3 million in 2008. The cost decline is attributable to the lower volume of Treasury security transfers during the year, due in part to consolidation of some Treasury securities dealers. In 2009, the number of Fedwire Treasury securities transfers decreased 22.0 percent from 2008, to approximately 10.0 million.

Payments Services

The Reserve Banks work closely with Treasury's Financial Management Service and other government agencies to process payments to individuals and companies. The Banks process electronic and paper-based disbursements such as Social Security and veterans' benefits, income tax refunds, and other types of payments. Reserve Bank operating expenses for payments-related activity totaled $104.4 million in 2009, compared with $108.2 million in 2008. The decline in costs is primarily attributable to the staff reductions in the Banks' Treasury check operations.

In 2009, the Reserve Banks processed 1.2 billion ACH payments for Treasury, an increase of 5.4 percent from 2008. The Banks also processed 202.2 million Treasury checks, a decrease of 25.0 percent from 2008. The decrease in Treasury checks is roughly equivalent to the increase experienced in 2008 due to the economic stimulus payments issued that year.

The increase in the number of ACH payments (relative to check payments) is consistent with Treasury's longstanding goal to make all payments electronically. Similar to the experience of the commercial check-collection service discussed earlier in this chapter, the proportion of Treasury checks presented to the Reserve Banks for processing in image form continued to increase as the number of depository institutions depositing checks in image form with the Banks increased. By year-end 2009, 99.1 percent of Treasury checks presented to the Banks were presented in image form. The shift in form from paper to images has increased the efficiency of processing Treasury checks, and resulted in lower staffing levels at the Banks and lower costs to the Treasury.

The Reserve Banks support Treasury's ongoing effort to convert paper checks to electronic payments through support of the Go Direct initiative (www.godirect.org), which focuses on converting check benefit payments to direct deposit. In 2009, more than 692,000 check payments were converted to direct deposit, an increase of 20.0 percent from the number of conversions in 2008. The Banks also operate an international electronic payment service that supports government benefit and other payments to more than 150 countries. In 2009, the Banks processed nearly $24.0 billion in international payments, compared with $22.5 billion in 2008. During the year, the Banks improved operational efficiency by reducing the number of service providers used to make international payments.

Collection Services

The Reserve Banks also work closely with Treasury's Financial Management Service to collect funds owed the federal government—such as federal taxes—and fees for its goods and services.

Reserve Bank operating expenses related to collections services totaled $38.0 million in 2009, compared with $49.2 million in 2008. The decline in costs is due to the transition of two collection programs from the Reserve Banks to a commercial bank at the end of 2008.

Throughout 2009, the Reserve Banks and Treasury continued work on the Collections and Cash Management Modernization (CCMM) initiative, a multiyear Treasury effort to simplify, modernize, and improve the services, systems, and processes supporting Treasury's collections and cash management programs. The Banks actively support various aspects of the CCMM initiative, including development of new applications to support both collection of funds and monitoring of collateral pledged to government programs.

To support the collection of federal taxes, the Reserve Banks operate several systems to process both electronic and paper tax payments. For example, the Banks operate the Federal Electronic Tax Application (FR-ETA), a same-day electronic federal tax payment system. In 2009, depository institutions submitted $452.2 billion in tax payments through FR-ETA.

The Reserve Banks also process paper federal tax deposit coupons submitted by depository institutions. The Banks processed 24.6 million coupons with a dollar value of $42.1 billion in 2009, compared with 29.5 million coupons with a dollar value of $54.9 billion in 2008. There are expected to be further declines in paper tax coupon payments in the coming years as the federal government continues to promote participation in electronic tax payment mechanisms.

In support of the collection of funds to pay for goods and services provided by the federal government, the Reserve Banks operate Pay.gov, a Treasury program that allows the public to use the Internet to authorize and initiate payments to federal agencies. During the year, the Pay.gov program was expanded to include several new agencies. In 2009, Pay.gov processed transactions worth $64.9 billion, compared with $44.1 billion in 2008.

The Reserve Banks also operate software that supports the settlement of transactions from Pay.gov and two other Treasury collection programs. In 2009, the Banks processed 62.9 million transactions valued at $99.5 billion, compared with 46.4 million transactions valued at $74.9 billion in 2008. As part of the CCMM initiative, the Banks are developing a more broadly based settlement framework that will support several additional collection applications. It is scheduled to replace the current system in 2010.

The Reserve Banks also support the government's centralized delinquent debt-collection program. Specifically, the Banks developed software that facilitates the collection of delinquent debts owed to federal agencies and states by matching federal payments against delinquent debts, including past-due child support payments owed to custodial parents. The Banks helped Treasury collect more than $4.8 billion through this program in fiscal year 2009.

Treasury Cash-Management Services

Treasury maintains an operating cash account at the Reserve Banks to support the various transactions discussed in the preceding sections of this chapter, and it may instruct the Banks to invest funds from its account in interest-bearing accounts with qualified depository institutions.

The Reserve Banks provide collateral-management and collateral-monitoring services for Treasury's investment programs and other Treasury programs that have collateral requirements. Reserve Bank operating expenses related to these programs and other cash-management initiatives totaled $49.0 million in 2009, compared with $48.7 million in 2008. The slight cost increase is due to additional work associated with application development initiatives supporting Treasury's CCMM initiative.

During 2009, the Reserve Banks continued to support Treasury's effort to modernize its financial management processes, with a focus on improving centralized government accounting and reporting functions. The Banks worked with Treasury to identify potential, long-term efficiency improvements in the way the Banks account for government payments and collections. The Banks also collaborated with the Financial Management Service on several ongoing software development efforts. For example, the Banks support Treasury's Governmentwide Accounting and Reporting Modernization initiative, which improves the timeliness of accounting data to support better financial analysis and decisionmaking.

To support Treasury's investment programs, the Reserve Banks continued to maintain several software applications. Treasury investments are fully collateralized, and the Banks monitor the collateral pledged to Treasury. The Banks also monitor collateral pledged to other Treasury programs, such as collateral pledged to secure public funds held on deposit at financial institutions. In addition, as part of the CCMM initiative, the Banks began working with the Financial Management Service to develop a new collateral application that will replace the legacy applications and provide support to other new cash-management applications developed as part of the CCMM initiative.

Computer Infrastructure and Other Treasury Services

The Reserve Banks operate a web-application infrastructure and provide other technology-related services to Treasury. The infrastructure supports multiple Treasury applications, primarily for the Financial Management Service.

Reserve Bank operating expenses for the infrastructure and other technology-related services—the costs of which are shared by the Financial Management Service and the Bureau of the Public Debt—were $67.0 million in 2009, compared with $65.1 in 2008. The web-application infrastructure accounts for the majority of the costs, and the Banks worked closely with Treasury to contain these costs, even as the number of applications supported by the infrastructure continued to increase.

Although the Reserve Banks primarily work with the Financial Management Service and Bureau of the Public Debt on fiscal programs, the Banks also support other fiscal programs, such as Treasury's debt-management program and its exchange stabilization fund. Reserve Bank operating expenses for these programs were $40.4 million in 2009, compared with $27.0 million in 2008. The cost increase is primarily due to the development and implementation of a debt-management application.

Services Provided to Other Entities

When permitted by federal statute or when required by the Secretary of the Treasury, the Reserve Banks provide fiscal agency and depository services to other domestic and international entities.

Book-entry securities issuance and maintenance activities account for a significant amount of the work performed for other entities, with the majority performed for the Federal Home Loan Mortgage Association, the Federal National Mortgage Association, and the Government National Mortgage Association.

The Reserve Banks also process paid postal money orders for the United States Postal Service, activity that accounts for roughly a quarter of the Banks' costs for services provided to other non-Treasury entities. Reserve Bank operating expenses for services provided to other entities were $27.8 million in 2009, compared with $31.3 million in 2008. The decline in costs is due in part to staff reductions in the Banks' postal money orders processing operations. Like Treasury checks, postal money orders are processed primarily in image form now, resulting in operational improvements and lower staffing levels at the Banks and lower costs to the U.S. Postal Service.

Developments in Use of Federal Reserve Intraday Credit

The Board's Payment System Risk (PSR) policy governs the use of Federal Reserve Bank intraday credit, also known as daylight overdrafts.

A daylight overdraft occurs when an institution's account activity creates a negative balance in the institution's Federal Reserve account at any time in the operating day.[11] Daylight overdrafts enable institutions to send payments more freely throughout the day than if institutions were limited strictly by their available funds balance. In 2009, institutions held on average about $900 billion in their Federal Reserve accounts overnight, but the daily value of funds transferred over just the Federal Reserve's funds transfer system was about $2.5 trillion.

In December 2008, the Board approved revisions to its PSR policy that will become effective in late 2010 or early 2011.[12] The revisions will, in part, allow eligible institutions to collateralize daylight overdrafts and pay no fee for these overdrafts. The Reserve Banks have begun work to modify the systems they use to record collateral pledges and to track daylight overdrafts. In March 2009, the Board implemented an interim policy change for eligible foreign banking organiza-

11. When an institution ends a day with a negative balance, the institution incurs an overnight overdraft. The Federal Reserve strongly discourages overnight overdrafts by imposing penalties and taking administrative action against institutions that incur them repeatedly. Institutions that require overnight credit are encouraged to approach the Federal Reserve's discount window to borrow funds as necessary.

12. Details about the revisions to the PSR policy are available at www.federalreserve.gov/newsevents/press/other/20081219a.htm, and the current policy is available at www.federalreserve.gov/paymentsystems/psr_policy.htm.

tions (FBOs).[13] The interim policy allows highly rated FBOs to use a streamlined procedure to apply for a max cap and allows these institutions to use 100 percent of their capital measure in calculating the deductible amount for daylight overdraft pricing. To remain eligible for the higher deductible value under the new policy, an FBO must have collateral pledged to its Reserve Bank equal to or greater than the amount of its deductible. Under the previous policy, FBOs were eligible to use up to 35 percent of their capital measure in the calculation of the deductible and net debit cap. FBOs introduce greater risks than do U.S.-chartered institutions in terms of the timeliness and scope of available supervisory information and other supervisory issues that may arise because of the cross-border nature of the FBO's business (for example, application of different legal regimes).

Recent Trends in Daylight Overdraft Usage

During the periods of extreme market stress in 2008, the level of daylight overdrafts spiked and then dropped to historical lows as balances institutions held at the Reserve Banks spiked to historically high levels. Both daylight overdrafts and Federal Reserve account balances have remained at these historic levels throughout 2009. The average level of average daylight overdrafts in 2009 was about $10 billion, or about 84 percent lower than the average 2008 level.[14] The average level of peak daylight overdrafts decreased to about $55 billion in 2009, a decrease of about 67 percent from 2008.[15] Daylight overdraft fees paid by institutions also dropped sharply as daylight overdraft levels decreased. In 2008, institutions paid about $52 million in daylight overdraft fees but only $4 million in 2009.

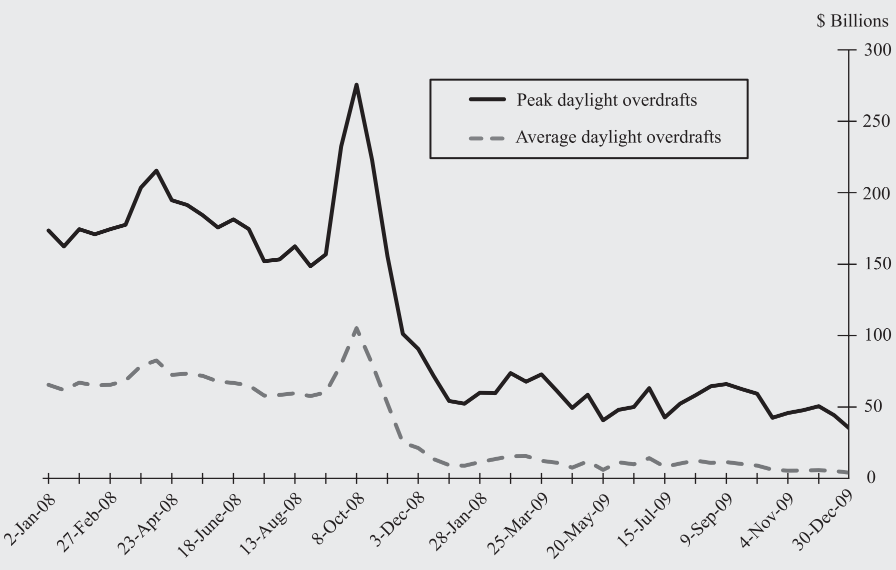
The usage of daylight overdrafts spiked amid the market turmoil near the end of 2008, but dropped sharply as various liquidity programs initiated by the Federal Reserve took effect (see the chart, next page). During this period, the Federal Reserve also began paying interest on balances held at the Reserve Banks, increased its lending under the Term Auction Facility, and began purchasing government-sponsored enterprise mortgage-backed securities. These measures tended to increase balances institutions held at the Banks, which decreased the demand for intraday credit. In 2008, reserve balances averaged $180 billion and spiked about 400 percent, to an average of about $900 billion in 2009. Furthermore, in 2009 the rate paid on reserve balances remained, on average, about nine basis points more than the effective federal funds rate, which is the rate at which depository institutions lend balances to each other overnight. This spread gives institutions incentive to hold higher balances at the Federal Reserve, and it has likely contributed

13. Details about the interim changes are available at www.federalreserve.gov/paymentsystems/psr_policy.htm#streamproc.

14. Average overdrafts are calculated daily by summing all negative balances incurred by institutions across the Federal Reserve System for each minute of the Fedwire operating day (9 p.m. to 6:30 p.m. ET or 21.5 hours). This sum is then divided by the number of minutes in the day (1,291 minutes) to arrive at the average overdraft.

15. Peak overdrafts are calculated daily by summing the negative balances of all institutions on a minute-by-minute basis throughout the Fedwire operating day (9 p.m. to 6:30 p.m. ET or 21.5 hours). The most negative of these minute-by-minute balances is the peak overdraft.

Aggregate Daylight Overdrafts, 2008–2009



Note: Rates reported on a biweekly frequency, ending on Wednesdays.

to very low daylight overdraft usage throughout the System.

Electronic Access to Reserve Bank Services

The Reserve Banks provide several options to enable customers to access the Banks' financial services information and payment services electronically. Most depository institutions that directly access the Banks' Fedwire Funds, Fedwire Securities, and FedACH services do so using FedLine Advantage connections, which provide web-based access. There were 5,673 FedLine Advantage connections at year-end 2009, 10 fewer than at year-end 2008.

The Reserve Banks' largest customers use FedLine Direct connections, which enable unattended computer-to-computer access to the Banks' financial services through dedicated connections. A large majority of the value transferred through the Banks' financial services flow through FedLine Direct connections, of which there were 256 at year-end 2009, 20 fewer than a year earlier.

Like FedLine Direct, FedLine Command enables computer-to-computer access. It provides an unattended, batch-file solution to certain services at a cost lower than that for FedLine Direct. There were 39 FedLine Command connections at year-end 2009, 22 more than a year earlier.

Many institutions access Reserve Bank information services and perform limited transaction services through FedLine Web. There were 2,979 FedLine Web connections at year-end 2009, 43 more than a year earlier.

Also in 2009, the Federal Reserve Banks completed the Tier 1 Data Delivery Service, a cross-business file transfer utility for nonpayment services. This service replaces the BulkData service previously used to transfer low-risk files between the Federal Reserve Banks and customers.

Information Technology

In 2009, the Federal Reserve Banks continued to develop and implement their information technology (IT) strategy by strengthening IT governance, managing information security risk, and analyzing and coordinating the System's IT investments.

In 2009, Federal Reserve Information Technology (FRIT)[16] continued to lead Reserve Bank efforts to transition to a more-robust information security model. FRIT initiated a transition to a new information security assurance program for infrastructure systems, based on guidance from the National Institute of Science and Technology.[17] The new assurance program will allow the System to

- have a defined and consistent view of information security roles and responsibilities,
- enhance the security controls assessment testing program, and
- introduce an IS risk management function at all levels of the organization.

16. FRIT supplies national infrastructure and business line technology services to the Federal Reserve System, and provides thought leadership regarding the System information technology architecture and business use of technology.

17. NIST is a non-regulatory federal agency within the U.S. Department of Commerce whose mission is to promote U.S. innovation and industrial competitiveness by advancing measurement science, standards, and technology in ways that enhance economic security and improve quality of life.

In 2009, the Reserve Banks approved the following initiatives:

- the consolidation of all Reserve Bank helpdesk functions into a national IT helpdesk
- a strategy to consolidate and centrally manage Reserve Bank servers and storage
- a network strategy that adopts an enterprise approach to the provision, operation, and management of hardware and software that provide data, video, and voice communication for the Reserve Banks.

Examinations of the Federal Reserve Banks

Section 21 of the Federal Reserve Act requires the Board of Governors to order an examination of each Reserve Bank at least once a year. The Board performs its own reviews and engages a public accounting firm. The public accounting firm annually audits the combined financial statements of the Reserve Banks (see the "Federal Reserve Banks Combined Financial Statements" in the "Audits of the Federal Reserve System" section of this report) as well as the annual financial statements of each of the 12 Banks and the consolidated limited liability company (LLC) entities.

The Reserve Banks use the framework established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) to assess their internal controls over financial reporting, including the safeguarding of assets. In 2009, the Reserve Banks further enhanced their processes under the guidance of the COSO framework and the Sarbanes-Oxley Act of 2002.

Within this framework, the management of each Reserve Bank annually provides an assertion letter to its board of directors that confirms adherence to COSO standards. Similarly, each LLC annually provides an assertion letter to the board of directors of the Federal Reserve Bank of New York (the New York Reserve Bank). A public accounting firm issues an attestation report to each Bank's board of directors and to the Board of Governors.

In 2009, the Board engaged Deloitte & Touche LLP (D&T) to audit the individual and combined financial statements of the Reserve Banks and those of the consolidated LLC entities. Fees for D&T's services totaled $10 million. Of the total fees, $2 million were for the audits of the consolidated LLC entities that are associated with Federal Reserve actions to address the financial crisis and are consolidated in the financial statements of the New York Reserve Bank.[18] To ensure auditor independence, the Board requires that D&T be independent in all matters relating to the audit. Specifically, D&T may not perform services for the Reserve Banks or others that would place it in a position of auditing its own work, making management deci-

18. Each LLC reimburses the Board of Governors for the fees related to the audit of its financial statements from the entity's available net assets.

Income, Expenses, and Distribution of Net Earnings
of the Federal Reserve Banks, 2009 and 2008

Millions of dollars

Item	2009	2008
Current income	54,463	41,046
Current expenses	5,979	4,870
Operating expenses[1]	3,694	3,232
Interest paid to depository institutions and earnings credits granted[2]	2,187	901
Interest expense on securities sold under agreements to repurchase	98	737
Current net income	48,484	36,175
Net additions to (deductions from, –) current net income	4,820	3,341
Profit on sales of U.S. Treasury securities	0	3,769
Profit on sales of federal agency and government-sponsored enterprise mortgage-backed securities	879	. . .
Profit on foreign exchange transactions	172	1,266
Net income (loss) from consolidated limited liability companies	5,588	–1,693
Provisions for loan restructuring[3]	–2,621	. . .
Other additions[4]	802	. . .
Assessments by the Board of Governors	888	853
For Board expenditures	386	352
For currency costs	502	500
Change in funded status of benefit plans	1,007	–3,159
Comprehensive income before distributions to Treasury	53,423	35,504
Dividends paid	1,428	1,190
Transferred to surplus and change in accumulated other comprehensive income	4,564	2,626
Distributions to U.S. Treasury[5]	47,431	31,689

1. Includes a net periodic pension expense of $663 million in 2009 and $160 million in 2008.

2. In October 2008, the Reserve Banks began to pay interest to depository institutions on qualifying balances.

3. Represents the economic effect of the interest rate reduction made pursuant to the April 17, 2009, restructuring of the American International Group, Inc. loan.

4. Includes dividends on preferred securities, unrealized gain on Term Asset-Backed Securities Loan Facility loans, and compensation paid by Citigroup, Inc. and Bank of America Corporation for the New York Reserve Bank's and Richmond Reserve Bank's commitments to provide funding support, net of related expenses.

5. Interest on Federal Reserve notes.

. . . Not applicable.

sions on behalf of the Reserve Banks, or in any other way impairing its audit independence. In 2009, one Reserve Bank engaged D&T for nonaudit consulting services for which the fees were immaterial.

The Board's annual examination of the Reserve Banks includes a wide range of off-site and on-site oversight activities, conducted primarily by the Division of Reserve Bank Operations and Payment Systems. Division personnel monitor the activities of each Bank and LLC on an ongoing basis and conduct a comprehensive on-site review of each Bank at least once every three years.

The reviews also include an assessment of the internal audit function's conformance to *International Standards for the Professional Practice of Internal Auditing*, conformance to applicable policies and procedures, and the audit department's efficiency.

To assess compliance with the policies established by the Federal Reserve's Federal Open Market Committee (FOMC), the division also reviews the accounts and holdings of the System Open Market Account (SOMA) at the New York Reserve Bank and the foreign currency operations conducted by that Reserve Bank. In addition, D&T audits the year-end schedule of participated asset and liability accounts and the related schedule of participated income accounts. The FOMC receives the external audit reports and a report on the division's examination.

Income and Expenses

The table on the previous page summarizes the income, expenses, and distributions of net earnings of the Reserve Banks for 2009 and 2008. Income in 2009 was $54,463 million, compared with $41,046 million in 2008.

Expenses totaled $6,867 million ($3,694 million in operating expenses, $2,187 million in interest paid to depository institutions on reserve balances and earnings credits granted to depository institutions, $98 million in interest expense on securities sold under agreements to repurchase, $386 million in assessments for Board of Governors expenditures, and $502 million for currency costs).[19] Net additions to and deductions from current net income showed a net profit of $4,820 million, which consists of $879 million in realized gains on federal agency and government-sponsored enterprise mortgage-backed securities (GSE MBS), $5,588 million in net income associated with consolidated LLCs, $802 million of other additions, and $172 million in unrealized gains on investments denominated in foreign currencies revalued to reflect current market exchange rates. These net additions were offset by a $2,621 million provision for loan restructuring.[20] Dividends paid to member banks, set at 6 percent of paid-in capital by section 7(1) of the Federal Reserve Act, totaled $1,428 million, $238 million more than in 2008; this reflects an increase in the capital and surplus of member banks and a consequent increase in the paid-in capital stock of the Reserve Banks.

Distributions to the U.S. Treasury in the form of interest on Federal Reserve notes totaled $47,431 million in 2009, up from $31,689 million in 2008; the distributions equal net income after the deduction of dividends paid and the amount necessary

---

19. Effective October 9, 2008, the Reserve Banks began paying explicit interest on reserve balances held by depository institutions at the Reserve Banks as authorized by the Emergency Economic Stabilization Act of 2008.

20. Represents the economic effect of the reduction of the interest note on loans made to American International Group, Inc. prior to April 17, 2009, as part of the loan restructuring that occurred on that date.

SOMA Holdings and Loans of the Federal Reserve Banks, 2009 and 2008

Millions of dollars except as noted

Item	Average daily assets (+)/ liabilities(–)		Current income (+)/ expense (–)		Average interest rate (percent)	
	2009	2008	2009	2008	2009	2008
U.S. Treasury securities[1]	659,483	548,254r	22,873	25,532r	3.47	4.66r
Government-sponsored enterprise debt securities[1]	98,093	3,983r	2,048	99r	2.09	2.49r
Federal agency and government-sponsored enterprise mortgage-backed securities[2]	473,855	. . .	20,407	. . .	4.31	. . .
Investments denominated in foreign currencies[3]	24,898	24,220r	296	623	1.19	2.57
Central bank liquidity swaps[4]	177,688	161,778r	2,168	3,606	1.22	2.23r
Securities purchased under agreements to resell	3,616	86,227r	13	1,891	0.36	2.19r
Other SOMA assets[5]	458	. . .	1	. . .	0.22	. . .
Securities sold under agreements to repurchase	–67,837	–55,169r	–98	–737	0.14	1.34
Other SOMA liabilities[6]	–182	. . .	. . .	. . .	. . .	. . .
Total SOMA holdings	**1,370,072**	**769,293r**	**47,708**	**31,014**	**3.48**	**4.03r**
Primary, secondary, and seasonal credit	40,405	32,254r	204	512	0.50	1.59r
Term auction credit	291,487	174,025r	786	3,305	0.27	1.90r
Total loans to depository institutions	**332,892**	**206,279r**	**990**	**3,817**	**0.30**	**1.85r**
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF)	7,653	21,101r	73	470	0.95	2.24
Primary Dealer Credit Facility (PDCF) and other broker-dealer credit	7,502	28,401r	36	511	0.48	1.80r
Credit extended to American International Group, Inc. (AIG), net[7]	39,099	18,742r	3,996	2,367	10.22	12.63r
Term Asset-Backed Securities Loan Facility (TALF)[8]	23,228	. . .	414	. . .	1.78	. . .
Total loans to others	**77,482**	**68,244r**	**4,519**	**3,348**	**5.83**	**4.91r**
Total loans	**409,374**	**274,523r**	**5,509**	**7,165**	**1.35**	**2.61r**
Total SOMA holding and loans	**1,779,446**	**1,043,816r**	**53,217**	**38,179**	**2.99**	**3.66r**

r Restatements due to changes in previously reported data and recategorization.

1. Face value, net of unamortized premiums and discounts.

2. Face value of the securities, which is the remaining principal balance of the underlying mortgages, net of unamortized premiums and discounts. Does not include unsettled transactions.

3. Includes accrued interest. Investments denominated in foreign currencies are revalued daily at market exchange rates.

4. Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

5. Cash and short-term investments related to the federal agency and government-sponsored enterprise mortgage-backed securities portfolio.

6. Related to the purchases of federal agency and government-sponsored enterprise mortgage-backed securities that the seller fails to deliver on the settlement date.

7. Average daily balance includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring, and excludes undrawn amounts and credit extended to consolidated limited liability companies.

8. Represents the remaining principal balance. Excludes amount necessary to adjust TALF loans to fair value at December 31, which is reported in “Other assets” on the Statement of Condition of the Federal Reserve Banks in Table 9A in the “Statistical Tables” section of this report.

. . . Not applicable.

to equate the Reserve Banks’ surplus to paid-in capital.

In the “Statistical Tables” section of this report, table 10 details the income and expenses of each Reserve Bank for 2009, and table 11 shows a condensed statement for each Reserve Bank for the years 1914 through 2009; table 9 is a statement of condition for each Reserve Bank, and table 13 gives the number and annual salaries of officers and employees for each Reserve Bank.

A detailed account of the assessments and expenditures of the Board of Governors appears in the "Board of Governors Financial Statements" in the "Audits of the Federal Reserve System" section of this report.

SOMA Holdings and Loans

The Reserve Banks' average net daily holdings of securities and loans during 2009 amounted to $1,779,446 million, an increase of $735,630 million from 2008 (see table, previous page).

SOMA Securities Holdings

The average daily holdings of Treasury securities increased by $111,229 million, to an average daily amount of $659,483 million. The average daily holdings of GSE debt securities increased by $94,110 million, to an average daily amount of $98,093 million. The average daily holdings of federal agency and GSE MBS totaled $473,855 million. The increases are due to the purchase of Treasury securities, GSE debt securities, and federal agency and GSE MBS through the large-scale asset purchase program. Average daily holdings of securities purchased under agreements to resell in 2009 were $3,616 million, a decrease of $82,611 million from 2008, while the average daily balance of securities sold under agreements to repurchase was $67,837 million, an increase of $12,668 million from 2008. Average daily holdings of investments denominated in foreign securities in 2009 were $24,898 million, compared with $24,220 million in 2008. The average daily balance of central bank liquidity swap drawings was $177,688 million in 2009 and $161,778 million in 2008.

The average rates of interest earned on the Reserve Banks' holdings of Treasury and GSE debt securities decreased to 3.47 percent and 2.09 percent, respectively, in 2009. The average rate for federal agency and GSE MBS was 4.31 percent in 2009. The average interest rates for securities purchased under agreements to resell and securities sold under agreements to repurchase were 0.36 percent and 0.14 percent, respectively, in 2009. Investments denominated in foreign currencies and central bank liquidity swaps earned interest at average rates of 1.19 percent and 1.22 percent, respectively, in 2009.

Lending

In 2009, average daily primary, secondary, and seasonal credit extended increased $8,151 million to $40,405 million, and term auction credit extended under the Term Auction Facility increased $117,462 million to $291,487 million. The average rate of interest earned on primary, secondary, and seasonal credit decreased to 0.50 percent in 2009, from 1.59 percent in 2008, while the average interest rate on term auction credit decreased to 0.27 percent in 2009, from 1.90 percent in 2008.

During 2008, the Federal Reserve established several lending facilities under authority of section 13(3) of the Federal Reserve Act. These facilities included the Primary Dealer Credit Facility (PDCF), the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), and the American International Group, Inc. (AIG) credit extension. Amounts funded by the Reserve Banks under these programs are recorded as loans by the Banks. During 2009, the average daily holdings under the PDCF and AMLF were $7,502 million and $7,653 million, respectively, with average rates of interest earned of 0.48 percent and 0.95 percent, respectively. The average

Key Financial Data for Consolidated Limited Liability Companies (LLCs), 2009 and 2008

Millions of dollars

Item	Commercial Paper Funding Facility LLC (CPFF)[1]		TALF LLC[1]	Maiden Lane LLC[1]	
	2009	2008	2009	2009	2008
Net portfolio assets of the consolidated LLCs and the net position of the New York Reserve Bank (FRBNY) and subordinated interest holders					
Net portfolio assets[2]	14,233	334,910	298	28,140	30,635
Liabilities of consolidated LLCs	–173	–812	0	–1,137	–4,951
Net portfolio assets available[3]	14,060	334,098	298	27,003	25,684
Loans extended to the consolidated LLCs by the FRBNY [4]	9,379	333,020	0	29,233	29,086
Other beneficial interests[4,5]	. . .	. . .	102	1,248	1,188
Total loans and other beneficial interests	9,379	333,020	102	30,481	30,274
Cumulative change in net assets since the inception of the program[6]					
Allocated to FRBNY	4,681	1,078	20	–2,230	–3,402
Allocated to other beneficial interests	. . .	. . .	176	–1,248	–1,188
Cumulative change in net assets	4,681	1,078	196	–3,478	–4,590
Summary of consolidated LLC net income, including a reconciliation of total consolidated LLC net income to the consolidated LLC net income recorded by FRBNY					
Portfolio interest income[7]	4,224	1,707	0	1,476	1,561
Interest expense on loans extended by FRBNY[8]	–598	–620	0	–146	–268
Interest expense—other	0	0	–2	–61	–332
Portfolio holdings gains (losses)	8	3	0	–102	–5,497
Professional fees	–30	–12	–1	–55	–54
Net income (loss) of consolidated LLCs	3,604	1,078	–3	1,112	–4,590
Less: Net income (loss) allocated to other beneficial interests	. . .	. . .	699	–61	–1,188
Net income (loss) allocated to FRBNY	3,604	1,078	–702	1,173	–3,402
Add: Interest expense on loans extended by FRBNY, eliminated in consolidation	598	620	0	146	268
Net income (loss) recorded by FRBNY	4,202	1,698	–702[9]	1,319	–3,134

1. CPFF LLC was formed to provide liquidity to the commercial paper market. TALF LLC was formed in 2009 to purchase assets of the Term Asset-Backed Securities Loan Facility, which was formed to improve market conditions for asset-backed securities. Maiden Lane LLC was formed to acquire certain assets of Bear Stearns; Maiden Lane II LLC and Maiden Lane III LLC were formed to acquire certain assets of AIG and its subsidiaries.

2. TALF, Maiden Lane, Maiden Lane II, and Maiden Lane III holdings are recorded at fair value. Fair value reflects an estimate of the price that would be received upon selling an asset if the transaction were to be conducted in an orderly market on the measurement date. CPFF holdings are recorded at book value, which includes amortized cost and related fees.

3. Represents the net assets available for repayment of loans extended by FRBNY and other beneficiaries of the consolidated LLCs.

4. Book value. Includes accrued interest.

5. The other beneficial interest holders are the U.S. Treasury for TALF LLC, JPMorgan Chase for Maiden Lane LLC, and AIG for Maiden Lane II LLC and Maiden Lane III LLC.

6. Represents the allocation of the change in net assets and liabilities of the consolidated LLCs that are available for repayment of the loans extended by FRBNY and the other beneficiaries of the consolidated LLCs. The differences between the fair value of the net assets available and the face value of the loans (including accrued interest) are indicative of gains or losses that would be incurred by the beneficiaries if the assets had been fully liquidated at prices equal to the fair value.

7. Interest income is recorded when earned and includes amortization of premiums, accretion of discounts, and paydown gains and losses.

8. Interest expense recorded by each consolidated LLC on the loans extended by FRBNY is eliminated when the LLCs are consolidated in FRBNY's financial statements and, as a result, the consolidated LLCs' net income (loss) recorded by FRBNY is increased by this amount.

9. FRBNY earned $1,025 million on TALF loans during the year ended December 31, 2009, which offsets the net loss attributable to TALF LLC. Earnings on TALF loans include interest income of $414 million, gains on the valuation of $557 million, and administrative fees of $54 million.

. . . Not applicable.

Key Financial Data for Consolidated LLCs, 2009 and 2008—*continued*
Millions of dollars

Maiden Lane II LLC[1]		Maiden Lane III LLC[1]		Total LLCs	
2009	2008	2009	2008	2009	2008
15,912	19,195	22,797	27,256	81,380	411,996
−2	−2	−3	−48	−1,315	−5,813
15,910	19,193	22,794	27,208	80,065	406,183
16,005	19,522	18,500	24,384	73,117	406,012
1,037	1,003	5,193	5,022	7,580	7,213
17,042	20,525	23,693	29,406	80,697	413,225
−95	−329	0	0	2,654	−2,653
−1,037	−1,003	−899	−2,198	−3,184	−4,389
−1,132	−1,332	−899	−2,198	−530	−7,042
1,088	302	3,032	517	9,820	4,087
−238	−27	−296	−45	−1,278	−960
−33	−103	−171	−28	−267	−463
−604	−1,499	−1,239	−2,633	−1,937	−9,626
−12	−5	−27	−9	−125	−80
201	−1,332	1,299	−2,198	6,213	−7,042
−34	−1,003	1,299	−2,198	1,903	−4,389
235	−329	0	0	4,310	−2,653
238	27	296	45	1,278	960
473	−302	296	45	5,588	−1,693

daily balance of credit extended to AIG in 2009 was $39,099 million, which earned interest at an average rate of 10.22 percent.

Investments of the Consolidated LLCs

Additional lending facilities established during 2008 and 2009, under authority of section 13(3) of the Federal Reserve Act, involved creating and lending to consolidated LLCs.[21]

The consolidated LLCs were funded by the New York Reserve Bank, and acquired financial assets and financial liabilities pursuant to the policy objectives. The consolidated LLCs were determined to be variable interest entities, and the New York Reserve Bank is considered to be the primary beneficiary of each.[22] Consistent with gener-

21. For further information on the establishment and policy objectives of these consolidated LLCs, see the “Monetary Policy and Economic Developments” section of this report.

22. A VIE is an entity for which the value of the beneficiaries’ financial interests in the entity changes with changes in the fair value of its net assets. A VIE is consolidated by the financial interest holder that is determined to be the primary beneficiary of the VIE because the primary beneficiary will absorb a majority of the VIE’s expected losses, receive a majority of the VIE’s expected residual gains, or it is most closely associated with the VIE. To determine whether it is the primary beneficiary of a VIE, the Reserve Bank evaluates the VIE’s design and capital structure and the relationships among the variable interest holders.

ally accepted accounting principles, the assets and liabilities of these LLCs have been consolidated with the assets and liabilities of the New York Reserve Bank in the preparation of the statements of condition included in this report.[23] The proceeds at the maturity or the liquidation of the consolidated LLCs' assets will be used to repay the loans extended by the New York Reserve Bank. Information regarding the Reserve Banks' lending to the consolidated LLCs and the asset portfolios of each consolidated LLC is as described in the table on the previous page.

Federal Reserve Bank Premises

Several Reserve Banks took action in 2009 to upgrade and refurbish their facilities. The multiyear renovation program at the New York Reserve Bank's headquarters building continued, while the St. Louis Reserve Bank continued a long-term facility redevelopment program that now involves renovation of the Bank's headquarters building. The New York Reserve Bank completed a program to enhance the business resiliency of its information technology systems and to upgrade facility support for the Bank's open market operations, central bank services, and data center operations. The New York Reserve Bank also leased space in a nearby office building to accommodate staff growth. The Richmond Reserve Bank completed the construction of a new parking garage adjacent to its headquarters building.

Security-enhancement programs continued at several facilities, including the construction of security improvements to the Richmond Reserve Bank's headquarters building, the construction of a remote vehicle-screening facility for the Philadelphia Reserve Bank, and the design of a remote vehicle-screening facility for the Dallas Reserve Bank.

Additionally, the San Francisco Reserve Bank continued its efforts to sell the former Seattle Branch building.

For more information, see table 14 in the "Statistical Tables" section of this report, which details the acquisition costs and net book value of the Federal Reserve Banks and Branches. ■

23. As a consequence of the consolidation, the extensions of credit from the New York Reserve Bank to the consolidated LLCs are eliminated, the net assets of the consolidated LLCs appear as assets in table 9 in the "Statistical Tables" section of this report, and the liabilities of the consolidated LLCs to entities other than the New York Reserve Bank, including those with recourse only to the portfolio holdings of the consolidated LLCs, are included in "Other liabilities" in statistical table 9A.

Pro Forma Financial Statements for Federal Reserve Priced Services

Pro Forma Balance Sheet for Federal Reserve Priced Services, December 31, 2009 and 2008

Millions of dollars

Item	2009		2008	
Short-term assets (Note 1)				
Imputed reserve requirements on clearing balances	317.4		418.8	
Imputed investments	4,112.9		**6,211.4**	
Receivables	49.8		60.0	
Materials and supplies	1.5		2.1	
Prepaid expenses	19.4		29.2	
Items in process of collection	449.7		983.1	
Total short-term assets		4,950.7		**7,704.7**
Long-term assets (Note 2)				
Premises	346.3		441.1	
Furniture and equipment	81.4		113.0	
Leases, leasehold improvements, and long-term prepayments	76.3		76.7	
Prepaid pension costs	77.1		0.0	
Prepaid FDIC asset	31.2		...	
Deferred tax asset	231.4		313.2	
Total long-term assets		843.7		944.0
Total assets		5,794.5		**8,648.7**
Short-term liabilities				
Clearing balances	3,173.6		**4,188.5**	
Deferred-availability items	1,728.3		2,779.8	
Short-term debt	0.0		0.0	
Short-term payables	146.9		573.5	
Total short-term liabilities		5,048.8		**7,541.8**
Long-term liabilities				
Long-term debt	0.0		0.0	
Accrued benefit costs	436.8		605.6	
Total long-term liabilities		436.8		605.6
Total liabilities		5,485.5		**8,147.4**
Equity (including accumulated other comprehensive loss of $478.3 million and $690.6 million at December 31, 2009 and 2008, respectively)		309.0		**501.3**
Total liabilities and equity (Note 3)		5,794.5		**8,648.7**

NOTE: Components may not sum to totals because of rounding. Amounts in bold reflect restatements due to recategorization. The accompanying notes are an integral part of these pro forma priced services financial statements.

Pro Forma Income Statement for Federal Reserve Priced Services, 2009 and 2008

Millions of dollars

Item	2009		2008	
Revenue from services provided to depository institutions (Note 4)		662.7		773.4
Operating expenses (Note 5)		713.8		808.7
Income from operations		–51.1		–35.3
Imputed costs (Note 6)				
Interest on float	–3.2		–22.4	
Interest on debt	0.0		0.0	
Sales taxes	9.1		9.4	
FDIC Insurance	3.4	9.2	0.5	–12.5
Income from operations after imputed costs		–60.3		–22.8
Other income and expenses (Note 7)				
Investment income	16.6		181.2	
Earnings credits	–3.9	12.7	–80.7	100.4
Income before income taxes		–47.6		77.6
Imputed income taxes (Note 6)		–15.5		24.2
Net income		–32.1		53.4
MEMO: Targeted return on equity (Note 6)		19.9		66.5

NOTE: Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.

Pro Forma Income Statement for Federal Reserve Priced Services, by Service, 2009

Millions of dollars

Item	Total	Commercial check collection	Commercial ACH	Fedwire funds	Fedwire securities
Revenue from services (Note 4)	662.7	481.7	92.9	64.4	23.7
Operating expenses (Note 5)	713.8	520.1	98.8	69.8	25.2
Income from operations	–51.1	–38.4	–5.9	–5.4	–1.4
Imputed costs (Note 6)	9.2	6.0	1.6	1.3	0.4
Income from operations after imputed costs	–60.3	–44.3	–7.5	–6.6	–1.9
Other income and expenses, net (Note 7)	12.7	9.2	1.8	1.3	0.5
Income before income taxes	–47.6	–35.2	–5.7	–5.4	–1.4
Imputed income taxes (Note 6)	–15.5	–11.5	–1.9	–1.8	–0.5
Net income	–32.1	–23.7	–3.8	–3.6	–0.9
MEMO: Targeted return on equity (Note 6)	19.9	14.4	2.9	2.0	0.7
Cost recovery (percent) (Note 8)	92.8	92.8	93.4	92.1	93.8

NOTE: Components may not sum to totals because of rounding. The accompanying notes are an integral part of these pro forma priced services financial statements.

FEDERAL RESERVE BANKS

Notes to Pro Forma Financial Statements for Priced Services

(1) Short-Term Assets

The imputed reserve requirement on clearing balances held at Reserve Banks by depository institutions reflects a treatment comparable to that of compensating balances held at correspondent banks by respondent institutions. The reserve requirement imposed on respondent balances must be held as vault cash or as balances maintained at a Reserve Bank; thus, a portion of priced services clearing balances held with the Federal Reserve is shown as required reserves on the asset side of the balance sheet. Another portion of the clearing balances is used to finance short-term and long-term assets. The remainder of clearing balances and deposit balances arising from float are assumed to be invested in a portfolio of investments, shown as imputed investments.

Receivables are comprised of fees due the Reserve Banks for providing priced services and the share of suspense-account and difference-account balances related to priced services.

Materials and supplies are the inventory value of short-term assets.

Prepaid expenses include salary advances and travel advances for priced-service personnel.

Items in process of collection are gross Federal Reserve cash items in process of collection (CIPC), stated on a basis comparable to that of a commercial bank. They reflect adjustments for intra-System items that would otherwise be double-counted on a consolidated Federal Reserve balance sheet; adjustments for items associated with nonpriced items (such as those collected for government agencies); and adjustments for items associated with providing fixed availability or credit before items are received and processed. Among the costs to be recovered under the Monetary Control Act is the cost of float, or net CIPC during the period (the difference between gross CIPC and deferred-availability items, which is the portion of gross CIPC that involves a financing cost), valued at the federal funds rate.

(2) Long-Term Assets

Long-term assets consist of long-term assets used solely in priced services, the priced-service portion of long-term assets shared with nonpriced services, an estimate of the assets of the Board of Governors used in the development of priced services, an imputed prepaid FDIC asset (see Note 6), and a deferred tax asset related to the priced services pension and postretirement benefits obligation (see Note 3).

(3) Liabilities and Equity

Under the matched-book capital structure for assets, short-term assets are financed with short-term payables and clearing balances. Long-term assets are financed with long-term liabilities and core clearing balances. As a result, no short- or long-term debt is imputed. Other short-term liabilities include clearing balances maintained at Reserve Banks. Other long-term liabilities consist of accrued postemployment, postretirement, and qualified and nonqualified pension benefits costs and obligations on capital leases.

Effective December 31, 2006, the Reserve Banks implemented the Financial Accounting Standard Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (codified in FASB Accounting Standards Codification (ASC) Topic 715 (ASC 715), *Compensation-Retirement Benefits*), which requires an employer to record the funded status of its benefit plans on its balance sheet. In order to reflect the funded status of its benefit plans, the Reserve Banks recognized the deferred items related to these plans, which include prior service costs and actuarial gains or losses, on the balance sheet. This resulted in an adjustment to the pension and benefit plans related to priced services and the recognition of an associated deferred tax asset with an offsetting adjustment, net of tax, to accumulated other comprehensive income (AOCI), which is included in equity. The Reserve Bank priced services recognized a net pension asset in 2009 and a net pension liability in 2008. The increase in the funded status resulted in a corresponding change in AOCI of $(212.3) million in 2009.

To satisfy the FDIC requirements for a well-capitalized institution, equity is imputed at 10 percent of total risk-weighted assets.

(4) Revenue

Revenue represents fees charged to depository institutions for priced services and is realized from each institution through one of two methods: direct charges to an institution's account or charges against its accumulated earnings credits (see Note 7).

(5) Operating Expenses

Operating expenses consist of the direct, indirect, and other general administrative expenses of the Reserve Banks for priced services plus the expenses of the Board of Governors related to the development of priced services. Board expenses were $7.8 million in 2009 and $7.2 million in 2008.

Effective January 1, 1987, the Reserve Banks implemented SFAS No. 87, *Employers' Accounting for Pensions* (codified in ASC 715). Accordingly, the Reserve Bank priced services recognized qualified pension-plan operating expenses of $121.2 million in 2009 and $28.8 million in 2008. Operating expenses also include the nonqualified pension expense of $2.3 million in 2009 and $5.4 million in 2008. The implementation of SFAS No. 158 (ASC 715) does not change the systematic approach required by generally accepted accounting principles to recognize the expenses associated with the Reserve Banks' benefit plans in the income statement. As a result, these expenses do not include amounts related to changes in the funded status of the Reserve Banks' benefit plans, which are reflected in AOCI (see Note 3).

The income statement by service reflects revenue, operating expenses, imputed costs, other income and expenses, and cost recovery. Certain corporate overhead costs not closely related to any particular priced service are allocated to priced services based on an expense-ratio method. Corporate overhead was allocated among the priced services during 2009 and 2008 as follows (in millions):

	2009	2008
Check	22.0	31.0
ACH	5.0	4.6
Fedwire Funds	3.3	3.5
Fedwire Securities	1.8	1.9
Total	32.1	41.2

(6) Imputed Costs

Imputed costs consist of income taxes, return on equity, interest on debt, sales taxes, an FDIC assessment, and interest on float. Many imputed costs are derived from the private-sector adjustment factor (PSAF) model. The cost of debt and the effective tax rate are derived from bank holding company data, which serves as the proxy for the financial data of a representative private-sector firm, and are used to impute debt and income taxes in the PSAF model. The after-tax rate of return on equity is based on the returns of the equity market as a whole and is applied to the equity on the balance sheet to impute the profit that would have been earned had the services been provided by a private-sector firm. On October 9, 2008, the Federal Reserve began paying interest on required reserve and excess balances held by depository institutions at Reserve Banks as authorized by the Emergency Economic Stabilization Act of 2008. In 2009, in contrast to previous years and in light of the uncertainty about the long-term effect that this change would have on the level of clearing balances on the balance sheet, the equity used to determine the imputed profit was adjusted to reflect actual clearing balance levels maintained throughout 2009.

Interest is imputed on the debt assumed necessary to finance priced-service assets; however, no debt was imputed in 2009 or 2008.

Effective in 2007, the Reserve Bank priced services imputed a one-time FDIC assessment credit. In 2009, the credit offset $8.0 million of the imputed $11.4 million assessment, resulting in zero remaining credit. The imputed FDIC assessment also reflects the increased rates and new assessment calculation methodology approved in 2009, which resulted in a prepaid FDIC asset of $31.2 million on the priced services balance sheet.

Interest on float is derived from the value of float to be recovered, either explicitly or through per-item fees, during the period. Float costs include costs for the Check, Fedwire Funds, National Settlement Service, ACH, and Fedwire Securities services.

Float cost or income is based on the actual float incurred for each priced service. Other imputed costs are allocated among priced services according to the ratio of operating expenses, less shipping expenses, for each service to the total expenses, less the total shipping expenses, for all services.

The following shows the daily average recovery of actual float by the Reserve Banks for 2009 in millions of dollars:

Total float	–1,974.1
Unrecovered float	4.7
Float subject to recovery	–1,978.8
Sources of recovery of float	
As-of adjustments	2.3
Direct charges	10.9
Per-item fees	–1,992.0

Unrecovered float includes float generated by services to government agencies and by other central bank services. As-of adjustments and direct charges refer to float that is created by interterritory check transportation and the observance of non-standard holidays by some depository institutions. Such float may be recovered from the depository institutions through adjustments to institution reserve or clearing balances or by billing institutions directly. Float recovered through direct charges and per-item fees is valued at the federal funds rate; credit float recovered through per-item fees has been subtracted from the cost base subject to recovery in 2009.

(7) Other Income and Expenses

Other income and expenses consist of investment and interest income on clearing balances and the cost of earnings credits. Investment income on clearing balances for 2009 and 2008 represents the average coupon-equivalent yield on three-month Treasury bills plus a constant spread, based on the return on a portfolio of investments. Before October 9, 2008, the return was applied to the *total* clearing balance maintained, adjusted for the effect of reserve requirements on clearing balances. As a result of the Federal Reserve paying interest on required reserve and excess balances held by depository institutions at Reserve Banks beginning in October 2008 (see Note 6), the investment return is applied only to the *required* portion of the clearing balance. Other income also includes imputed interest on the portion of clearing balances set aside as required reserves. Expenses for earnings credits granted to depository institutions on their clearing balances are based on a discounted average coupon-equivalent yield on three-month Treasury bills.

(8) Cost Recovery

Annual cost recovery is the ratio of revenue, including other income, to the sum of operating expenses, imputed costs, imputed income taxes, and targeted return on equity.

The Board of Governors and the Government Performance and Results Act

The Government Performance and Results Act (GPRA) of 1993 requires that federal agencies, in consultation with Congress and outside stakeholders, prepare a strategic plan covering a multiyear period and submit an annual performance plan and performance report. Although the Federal Reserve is not covered by the GPRA, the Board of Governors voluntarily complies with the spirit of the act.

Strategic Plan, Performance Plan, and Performance Report

The Board's strategic plan articulates the Board's mission, sets forth major goals, outlines strategies for achieving those goals, and discusses the environment and other factors that could affect their achievement. It also addresses issues that cross agency jurisdictional lines, identifies key quantitative measures of performance, and discusses the evaluation of performance.

The performance plan includes specific targets for some of the performance measures identified in the strategic plan and describes the operational processes and resources needed to meet those targets. It also discusses validation of data and verification of results. The performance report discusses the Board's performance in relation to its goals.

The strategic plan, performance plan, and performance report are available on the Board's website, at www.federalreserve.gov/boarddocs/rptcongress. The Board's mission statement and a summary of the Federal Reserve's goals and objectives, as set forth in the most recently released strategic and performance plans, are listed below. Updated documents will be posted on the website as they are completed.

Mission

The mission of the Board is to foster the stability, integrity, and efficiency of the nation's monetary, financial, and payment systems to promote optimal macroeconomic performance.

Goals and Objectives

The Federal Reserve has six primary goals with interrelated and mutually reinforcing elements.

Goal

Conduct monetary policy that promotes the achievement of the statutory objectives of maximum employment and stable prices.

Objectives

- Stay abreast of recent developments in and prospects for the U.S. economy and financial markets, and in those abroad, so that monetary policy decisions will be well informed.
- Enhance our knowledge of the structural and behavioral relationships in the macroeconomic and financial markets, and improve the quality of the data used to gauge economic per-

formance, through developmental research activities.
- Implement monetary policy effectively in rapidly changing economic circumstances and in an evolving financial market structure.
- Contribute to the development of U.S. international policies and procedures, in cooperation with the U.S. Department of the Treasury and other agencies, with respect to global financial markets and international institutions.
- Promote understanding of Federal Reserve policy among other government policy officials and the general public.

Goal

Promote a safe, sound, competitive, and accessible banking system and stable financial markets.

Objectives

- Promote overall financial stability, manage and contain systemic risk, and identify emerging financial problems early so that crises can be averted.
- Provide a safe, sound, competitive, and accessible banking system through comprehensive and effective supervision of U.S. banks, bank and financial holding companies, foreign banking organizations, and related entities. At the same time, remain sensitive to the burden on supervised institutions.
- Enhance efficiency and effectiveness, while remaining sensitive to the burden on supervised institutions, by addressing the supervision function's procedures, technology, resource allocation, and staffing issues.
- Promote compliance by domestic and foreign banking organizations supervised by the Federal Reserve with applicable laws, rules, regulations, policies, and guidelines through a comprehensive and effective supervision program.

Goal

Develop regulations, policies, and programs designed to inform and protect consumers, to enforce federal consumer protection laws, to strengthen market competition, and to promote access to banking services in historically underserved markets.

Objectives

- Be a leader in, and help shape the national dialogue on, consumer protection in financial services.
- Promote, develop, and strengthen effective communications and collaborations within the Board, the Federal Reserve Banks, and other agencies and organizations.

Goal

Provide high-quality professional oversight of Reserve Banks.

Objective

- Produce high-quality assessments and oversight of Federal Reserve System strategies, projects, and operations, including adoption of technology to meet the business and operational needs of the Federal Reserve. The oversight process and outputs should help Federal Reserve management foster and strengthen sound internal control systems, efficient and reliable operations, effective performance, and sound project management and should assist the Board in the effective discharge of its oversight responsibilities.

Goal

Foster the integrity, efficiency, and accessibility of U.S. payment and settlement systems.

Objectives

- Develop sound, effective policies and regulations that foster payment system integrity, efficiency, and accessibility. Support and assist the Board in overseeing U.S. dollar payment and securities settlement systems by assessing their risks and risk-management approaches against relevant policy objectives and standards.
- Conduct research and analysis that contributes to policy development and increases the Board's and others' understanding of payment system dynamics and risk.

Goal

Foster the integrity, efficiency, and effectiveness of Board programs.

Objectives

- Develop appropriate policies, oversight mechanisms, and measurement criteria to ensure that the recruiting, training, and retention of staff meet Board needs.
- Establish, encourage, and enforce a climate of fair and equitable treatment for all employees regardless of race, creed, color, national origin, age, or sex.
- Provide strategic planning and financial management support needed for sound business decisions.
- Provide cost-effective and secure information resource management services to Board divisions, support divisional distributed-processing requirements, and provide analysis on information technology issues to the Board, Reserve Banks, other financial regulatory institutions, and central banks.
- Efficiently provide safe, modern, secure facilities and necessary support for activities conducive to efficient and effective Board operations. ■

Federal Legislative Developments

In May 2009, President Obama signed into law two significant pieces of legislation that include provisions affecting the Federal Reserve: the Credit Card Accountability, Responsibility, and Disclosure Act of 2009 (Pub. L. No. 111-24) (the "Credit Card Act"), which aims to improve practices in the credit card market, and the Helping Families Save Their Homes Act of 2009 (Pub. L. No. 111-22), which seeks to restore stability to the housing markets. Following is a summary of the key provisions of these laws as they relate to Federal Reserve System functions.

The Credit Card Act

The Federal Reserve played a key role in the development of the Credit Card Act, which introduces new substantive and disclosure requirements for creditors in an effort to strengthen consumer protections in the credit card market. Among other things, the Credit Card Act amends the Truth in Lending Act and the Electronic Fund Transfer Act, which are administered by the Board.

Several provisions of the Credit Card Act build on protections previously adopted by the Board. Specifically, in December 2008, the Board adopted two final rules pertaining to open-end credit (other than credit secured by a home):

- The first rule made comprehensive changes to Regulation Z (which implements the Truth in Lending Act), including amendments that affect credit card applications and solicitations, account-opening disclosures, periodic statements, notices of changes in terms, and advertisements.
- The second rule protected consumers by prohibiting certain unfair acts or practices, such as unexpected increases in interest rates, with respect to consumer credit card accounts.

The requirements of the Credit Card Act that pertain to credit cards or other open-end credit for which the Board has rulemaking authority become effective in three stages. The first set of provisions requires creditors to provide written notice to consumers 45 days before the creditor increases the annual percentage rate (APR) on a credit card account or makes a significant change to the terms of a credit card account. These notices also must inform consumers of their right to cancel the credit card account before the increase or change goes into effect. If a consumer exercises this right, the creditor generally is prohibited from applying the increase or change to the account prior to account closure. In addition, creditors are required to mail or deliver periodic statements for credit cards at least 21 days before payment is due. These Credit Card Act provisions became effective on August 20, 2009 (90 days after enactment). The Board approved interim final rules to implement these provisions on July 15, 2009.

A second set of Credit Card Act provisions protects consumers from certain types of increases in credit card interest rates and changes in terms. It does so by prohibiting, with certain exceptions, increases to an interest rate during the first year after an account has been opened, as well as increases to an interest rate that applies to an existing credit card balance. In addition, if a consumer makes a payment in excess of the minimum payment amount, creditors are required to allocate those excess funds first to the card balance with the highest interest rate, and then to each successive balance with the next highest rate, until the payment is exhausted. Creditors also are prohibited from

- using the "two-cycle" billing method to impose interest charges;[1]
- charging over-the-limit fees unless the cardholder has agreed to allow the issuer to complete over-the-limit transactions; and
- charging excessive fees on cards with low credit limits.

The Credit Card Act also requires that before opening a credit card account, or increasing the account limit, creditors consider the consumer's ability to make the required payments under the card agreement. Furthermore, the Credit Card Act prohibits creditors from issuing a credit card to, or establishing an open-end credit plan on behalf of, a consumer who is younger than the age of 21, unless the creditor either determines that the consumer has the independent ability to make the required payments or obtains the signature of a parent or other cosigner with the ability to do so. Creditors are further prohibited from offering a tangible item on or near a college campus to induce college students to apply for or participate in an open-end consumer credit plan.

In addition, for each credit card account, creditors must provide the consumer with a payment due date that is the same day each month, and with a disclosure setting forth the time and cost of paying off the card balance if only minimum monthly payments are made. This second set of provisions became effective on February 22, 2010 (nine months after enactment). The Board approved final rules to implement these provisions on January 12, 2010.

A third group of Credit Card Act provisions addresses the reasonableness and proportionality of penalty fees and periodic review of rate increases by creditors. Under these provisions, the Board is charged with establishing standards for creditors to use in assessing whether or not a penalty fee or charge is reasonable and proportional to the corresponding violation or omission. In developing these standards, the Board must consider the cost sustained by the creditor for the violation or omission, the effect of the fee in deterring omissions or violations by the cardholder, the cardholder's conduct, and other factors the Board considers necessary or appropriate. In addition, under certain circumstances, a credit card issuer who increases a cardholder's interest rate is required to review the cardholder's account at least every six months and assess whether a decrease in the rate is warranted due to a change in such factor(s). On March 3, 2010, the Board issued a proposed rule to implement the third group of Credit Card Act provisions. These provisions will become effective on August 22, 2010 (15 months after enactment).

1. The "two-cycle" billing method has several permutations. Generally, a card issuer that uses the two-cycle method assesses interest not only on the balance for the current billing cycle but also on balances on days in the preceding billing cycle. The two-cycle method results in greater interest charges for consumers who pay their balance in full one month (and therefore generally qualify for a grace period) but not the next month (and therefore generally lose the grace period).

The Credit Card Act also amends provisions of the Electronic Fund Transfer Act and generally prohibits the imposition of dormancy, inactivity, or service fees with respect to a gift certificate, store gift card, or general-use prepaid card. The Credit Card Act provides an exception to this general prohibition if there has been at least one year of inactivity, no more than one fee is charged per month, and the consumer is provided with clear and conspicuous disclosures about the fees. In addition, the Credit Card Act prohibits the sale or issuance of a gift certificate, store gift card, or general-use prepaid card that is subject to an expiration date of less than five years. These provisions will become effective on August 22, 2010. The Board finalized rules to implement these provisions on March 23, 2010.

The Credit Card Act also mandates that creditors post their credit card agreements on their Internet sites, and provide these agreements to the Board. The Board is required to establish and maintain a central repository so that the public may easily access and retrieve these agreements. Finally, the Credit Card Act requires the Board to conduct and complete several studies, and to make several reports to Congress, on college credit card agreements, the reduction of consumer credit availability, and the use of credit cards by small businesses.

The Helping Families Save Their Homes Act

On May 20, 2009, President Obama signed into law the Helping Families Save Their Homes Act (the "Helping Families Act") (Pub. L. No. 111-22), which, among other things, introduced new measures to aid families facing foreclosure. The Helping Families Act included a variety of provisions intended to encourage modification of home mortgages either in default or facing imminent default, including through the HOPE for Homeowners Program previously established by the Housing and Economic Recovery Act of 2008 (HERA) (Pub. L. No. 110-289). For example, the Helping Families Act included provisions that permit the Secretary of Housing and Urban Development (HUD) to authorize the modification of federally guaranteed rural housing loans and loans guaranteed by the Federal Housing Administration (FHA) either in default or facing imminent default, and to make payments to residential mortgage lenders in order to offset certain costs associated with modification. The Helping Families Act also provides certain liability protections to loan servicers who make modifications in compliance with the Act.

Described below are three provisions of the Act that directly relate to the activities and functions of the Federal Reserve or the banking organizations supervised by the Federal Reserve.

GAO Audit Authority

Title VIII of the Helping Families Act authorizes the Comptroller General of the U.S. Government Accountability Office (GAO) to conduct audits, including on-site examinations, of all the credit facilities authorized by the Board under section 13(3) of the Federal Reserve Act (12 U.S.C. § 343) for a single and specific partnership or corporation in order to protect financial stability and promote the flow of credit during the financial crisis.

Under this provision, the GAO has full authority to audit the special lending facilities that the Federal Reserve established under section 13(3) for American International Group, Inc.; Citigroup, Inc.; and Bank of America Corporation, and to facilitate the acquisition of The Bear Stearns Company, Inc. by JP Morgan Chase & Co., including Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC. The Helping Families Act prohibits an officer or employee of the GAO from disclosing to any person outside the GAO information obtained in audits or examinations conducted under this authority and maintained as confidential by the Board or the Federal Reserve Banks.

Title VI of the Helping Families Act also clarifies the GAO's authority to audit the programs established by the Treasury Department under the Troubled Asset Relief Program (TARP), including the Term Asset-Backed Securities Loan Facility (TALF), which is a joint program of the Federal Reserve and Treasury. The Emergency Economic Stabilization Act of 2008 (EESA) (Pub. L. No. 110-343), which established the TARP, expressly authorizes the GAO to audit the programs and activities of the Treasury under the TARP for purposes of conducting ongoing oversight of the activities and performance of the TARP. Section 601 of the Helping Families Act clarifies and ensures the GAO's ability to audit the TALF for purposes of assessing the performance of the TARP. Taken together, these provisions provide the GAO with the authority to audit the terms, conditions, and operations of the TALF, including those aspects of the TALF that are administered by the Federal Reserve, as necessary to understand and assess the performance of, and risks to, the TARP.

These provisions augment the GAO's existing audit authority with respect to the Federal Reserve. For example, all of the Federal Reserve's supervisory and regulatory functions are subject to audit by the GAO to the same extent as the supervisory and regulatory functions of the other federal banking agencies.

Temporary Increase in FDIC Borrowing Authority

The Helping Families Act also includes measures designed to preserve confidence in the deposit insurance fund and assist the Federal Deposit Insurance Corporation (FDIC) in recovering any costs of emergency assistance provided to help maintain financial stability during the financial crisis.

Specifically, the Helping Families Act increases, from $30 billion to $100 billion, the amount the FDIC may borrow from the Treasury for deposit insurance purposes. In addition, until December 31, 2010, the Helping Families Act allows the Secretary of the Treasury, after consulting with the President, to allow the FDIC to borrow up to $500 billion from Treasury if the Secretary determines that the increase is necessary after receiving the written recommendations of the Board of Directors of the FDIC and the Board of Governors of the Federal Reserve System (each by a vote of not less than two-thirds of the members of the respective board).

The Helping Families Act also permits the FDIC, with the concurrence of the Secretary of the Treasury, to make special assessments on depository institution holding companies, in addition to insured depository institutions, to recover any losses that the Deposit Insurance Fund may incur as a result of actions taken by the FDIC under the systemic risk exception to the least-cost resolution requirements in the Federal

Deposit Insurance Act (12 U.S.C. § 1823(c)(4)(G)). In establishing any such assessment rate, the FDIC must consider the types of entities that benefit from any action taken or assistance provided, economic conditions, the effects on the industry, and such other factors as the FDIC deems appropriate and relevant to the action taken or the assistance provided.

Moreover, the Helping Families Act extends, until December 31, 2013, the increase from $100,000 to $250,000 in FDIC deposit insurance coverage for insured depository institutions and National Credit Union Administration (NCUA) share insurance coverage for insured credit unions. This increase in deposit and share insurance initially was enacted as part of the EESA, but only through December 31, 2009.

The HOPE for Homeowners Program

Title II of the Helping Families Act makes several changes to the HOPE for Homeowners Program, a voluntary program designed to allow qualified, at-risk mortgage borrowers to refinance their existing mortgages into new mortgage loans guaranteed by the FHA, subject to certain conditions and restrictions. As originally enacted, the Board of Directors of the program (the "Oversight Board") was provided authority to establish requirements and standards for the program, prescribe regulations, and issue guidance to implement those requirements and standards. The Oversight Board is composed of the Secretary of HUD, the Chairman of the Board of Governors of the Federal Reserve System, the Secretary of the Treasury, and the Chairperson of the Board of Directors of the FDIC, or the respective designee of each. The Helping Families Act transferred all responsibilities of the Oversight Board to the Secretary of HUD and converted the Oversight Board into an advisory body with responsibility for advising the Secretary regarding the program.

The Helping Families Act also gives HUD additional flexibility with respect to the fees assessed for providing government insurance to mortgages refinanced under the program. Specifically, the Act permits HUD to assess an upfront premium of up to 3 percent, and an annual premium of up to 1.5 percent, of the principal balance of the new mortgage, taking into consideration the financial integrity and purpose of the program. Previously, the upfront and annual premiums were fixed at 3 percent and 1.5 percent of the principal balance of the new mortgage, respectively. Additionally, the Helping Families Act allows HUD to make payments to the servicer for loans refinanced under the program, and to originators for new loans made through the program to encourage refinancings for eligible borrowers. HUD is also given greater flexibility in establishing the percentage of any appreciation realized by a borrower on the property refinanced into the program that the borrower must share with HUD. HUD is permitted to share its portion of any appreciation received with either a senior or subordinate mortgage holder whose loans were refinanced pursuant to the program. The Helping Families Act makes several other technical changes to the program to decrease administrative burdens, such as streamlining certifications and allowing conformity with current FHA practices to the extent possible. ■

Records

Record of Policy Actions of the Board of Governors

This report provides a summary account of actions taken by the Board on questions of policy in 2009 as implemented through (1) rules and regulations, (2) policy statements and other actions, (3) special liquidity facilities and other initiatives, and (4) discount rates for depository institutions. All actions were approved by a unanimous vote of the Board members, unless indicated otherwise. More information on the actions with italicized dates is available via the online version of the Annual Report, from the "Reading Rooms" on the Board's FOIA web page, and on request from the Board's Freedom of Information Office.

Rules and Regulations

Regulation A
Extensions of Credit by Federal Reserve Banks

[Docket No. R-1371]

On *December 4, 2009,* the Board approved a final rule establishing a process by which the Federal Reserve Bank of New York may determine the eligibility of credit rating agencies for the Term Asset-Backed Securities Loan Facility (TALF), a special liquidity facility. (See "Special Liquidity Facilities and Other Initiatives" for further discussion of the TALF.) The rule establishes criteria for determining the eligibility of agencies to issue credit ratings for asset-backed securities, other than those backed by commercial real estate, to be accepted as collateral for the TALF. The final rule is effective January 8, 2010.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation D
Reserve Requirements of Depository Institutions

Regulation I
Issue and Cancellation of Federal Reserve Bank Capital Stock

[Docket Nos. R-1334, R-1350, and R-1307]

On *May 18, 2009,* the Board approved final rules (1) to direct Federal Reserve Banks to pay interest on certain balances held at Reserve Banks by or on behalf of certain depository institutions, (2) to authorize the establishment of "excess balance accounts" at Reserve Banks for the maintenance of excess balances of eligible institutions, (3) to increase from three to six the permissible number of transfers or withdrawals from savings deposits by check, debit card, or similar order payable to third parties, and (4) to authorize member banks to enter into pass-through arrangements. One of the final rules revises provisions of the interim final rule issued in October 2008 amending Regulation D. Those revisions relate to the payment of interest on respondent balances maintained in the accounts of "ineligible" pass-through correspondents (correspondent institutions ineligible to receive interest on balances maintained on their own behalf at the Federal Reserve), and the final rules implement other conforming amendments to Regulation D and Regulation I. The final rules are effective July 2, 2009.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation E
Electronic Fund Transfers

[Docket No. R-1343]

On *November 5, 2009,* the Board approved a final rule that prohibits financial institutions from paying overdrafts on ATM (automated teller machine) and one-time debit card transactions, unless the consumer affirmatively consents, or opts in, to the overdraft service for those types of transactions. Before opting in, a consumer must be provided with a notice that explains the financial institution's overdraft services, including any associated fees, and the consumer's choices. The amendments prohibit financial institutions from discriminating against consumers who do not opt in, and institutions must provide consumers who do not opt in with the same terms, conditions, and features (including pricing) that they provide to consumers who do opt in. The final rule, which includes a model opt-in notice, is effective January 19, 2010, and compliance is mandatory July 1, 2010.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation H
Membership of
State Banking Institutions
in the Federal Reserve System

Regulation Y
Bank Holding Companies
and Change in Bank Control

[Docket R-1332]

On *January 27, 2009,* the Board approved a final rule to provide a temporary exemption for state member banks and bank holding companies participating in the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), a special liquidity facility. Under the exemption, which was approved as an interim measure in September 2008, asset-backed commercial paper held by these institutions as a result of their participation in the AMLF is exempt from the Board's leverage risk-based capital guidelines. The final rule is effective January 30, 2009. (The Board subsequently announced that the AMLF would expire on February 1, 2010.)

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh and Duke.

[Docket No. R-1361]

On *June 23, 2009,* the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, and Office of Thrift Supervision, approved a joint interim final rule with request for comment to provide that mortgage loans modified under the Department of the Treasury's Home Affordable Mortgage Program (HAMP, formerly Making Home Affordable Program) will retain the risk weight assigned to the loan before the modification. The modified loans must continue to meet other applicable prudential criteria. On *November 2, 2009,* the Board and the other banking agencies approved the interim final rule as a final rule with a clarification that mortgage loans whose HAMP modifications are in the trial period, and not yet permanent, qualify for the rule's risk-based capital treatment. The final rule is effective December 21, 2009.

Votes for these actions: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation P
Privacy of Consumer Financial Information

[Docket No. R-1280]

On *October 26, 2009,* the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration, Federal Trade Commission, Commodity Futures Trading Commission, and Securities and Exchange Commission, approved a final rule to implement the privacy-notice and opt-out provisions of the Gramm-Leach-Bliley Act. Under the act, institutions must notify consumers of their information-sharing practices and inform consumers of their right to opt out of certain sharing practices. The rule includes a model privacy form that will make it easier for consumers to understand how financial institutions collect and share information about them. Financial institutions may rely on the model form as a safe harbor when providing privacy notices. The rule, which also removes sample clauses now included in an appendix to the regulation, is effective December 31, 2009 (except for the amendment removing the sample clauses, which is effective January 1, 2012).

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation S
Reimbursement for Providing Financial Records; Recordkeeping Requirements for Certain Financial Records

[Docket No. R-1325]

On *September 2, 2009,* the Board approved a revision to Regulation S to change the rates and conditions under which a government agency must reimburse a financial institution for costs incurred in producing customer financial records under the Right to Financial Privacy Act. The final rule is effective January 1, 2010.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation V
Fair Credit Reporting

[Docket Nos. R-1203 and R-1255]

On *January 26, 2009,* the Board, acting with the Federal Deposit Insurance Corporation (FDIC), Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), National Credit Union Administration (NCUA), and Federal Trade Commission (FTC), approved technical corrections to the rules regarding affiliate marketing, identity-theft red flags, and address discrepancies. The amendments are effective May 14, 2009, except for the instructions to appendix C, which are effective January 1, 2010.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh and Duke.

[Docket No. R-1300]

On *May 29, 2009,* the Board, acting with the FDIC, OCC, OTS, NCUA, and FTC, approved final rules to implement certain provisions of the Fair and Accurate Credit Transactions Act regarding entities that furnish information about consumers (furnishers) to consumer reporting agencies. Under the rules, furnishers must establish reasonable policies and procedures to ensure the accuracy and integrity of the information they provide. The rules also identify the circumstances under which a furnisher must investigate a consumer's direct dispute about the accuracy of information in his or her credit report. The rules are effective July 1, 2010.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

[Docket No. R-1316]

On *December 17, 2009,* the Board, acting with the FTC, approved final rules to implement the risk-based-pricing provisions of the Fair and Accurate Credit Transactions Act. Under the final rules, a creditor must generally provide a consumer with a risk-based-pricing notice when the creditor, on the basis of the consumer's credit report, provides credit to the consumer on less favorable terms than it provides to other consumers. The rules provide creditors with several methods for determining which consumers must receive notices and include exceptions to the notice requirement, such as when a creditor provides consumers who apply for credit with a free credit score and information about their score. The final rules are effective January 1, 2011.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation W
Transactions Between
Member Banks and Their Affiliates

[Docket No. R-1330]

On *January 27, 2009,* the Board approved a final rule to extend to October 30, 2009, a temporary exemption for member banks from certain provisions of section 23A of the Federal Reserve Act and the Board's Regulation W. The exemption, which was approved as an interim measure in September 2008, increases the capacity of member banks to enter into securities-financing transactions with their affiliates. The final rule is effective January 30, 2009. The Board allowed the rule to expire on October 30, 2009.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh and Duke.

[Docket No. R-1331]

On *January 27, 2009,* the Board approved a final rule to provide a temporary exemption for member banks participating in the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), a special liquidity facility. The exemption from certain provisions of section 23A of the Federal Reserve Act and the Board's Regulation W was approved as an interim measure in September 2008 and increases the capacity of participating institutions to purchase asset-backed commercial paper from affiliated money market mutual funds. The final rule is effective January 30, 2009. (The Board subsequently announced that the AMLF would expire on February 1, 2010.)

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh and Duke.

Regulation Y
Bank Holding Companies
and Change in Bank Control

[Docket No. R-1193]

On *March 16, 2009,* the Board approved a final rule to delay until March 31, 2011, the effective date of new limits on the inclusion of trust preferred securities and other restricted core capital elements in tier 1 capital under the Board's capital adequacy guidelines for bank holding companies. The new limits were scheduled to take effect on March 31, 2009, but were delayed in view of financial market conditions and in order to promote stability in the financial markets and the banking industry as a whole.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

[Docket Nos. R-1336 and R-1356]

On *May 20, 2009,* the Board approved a final rule to allow bank holding companies to include in tier 1 capital without restriction senior perpetual preferred stock issued to the Department of the Treasury (Treasury) under the Troubled Asset Relief Program (TARP). This rule makes final the rule approved as an interim measure in October 2008. The Board also approved an interim final rule with request for comment to allow bank holding companies that are either S-Corps or mutual bank holding companies to include in tier 1 capital all subordinated debt issued to Treasury under TARP, provided that the subordinated debt will count toward the limit on the amount of other restricted core capital includable in tier 1 capital. In addition, the interim final rule will allow small bank holding companies that are S-Corps or mutual bank holding companies to exclude such debt from treatment as "debt" for purposes of the debt-to-equity standard under the Board's Small Bank Holding Company Policy Statement. The final rule is effective July 1, 2009, and the interim final rule is effective June 1, 2009.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation Z
Truth in Lending

[Docket No. R-1340]

On *May 7, 2009,* the Board approved amendments to implement the Mortgage Disclosure Improvement Act (MDIA) that are intended to provide consumers with disclosures earlier in the mortgage process. In July 2008, the Board issued final rules requiring creditors to provide consumers with transaction-specific cost disclosures shortly after receiving an application for a closed-end loan secured by a consumer's principal dwelling. The MDIA expedites the effective date of these disclosure requirements by about two months, to July 30, 2009, as well as broadens and adds to the requirements. Under the Board's amendments to implement these requirements, creditors must (1) provide early cost disclosures for loans secured by dwellings other than a consumer's principal dwelling (such as a second home); (2) wait seven days after providing the early disclosures before closing the loan; and (3) provide new disclosures that include a revised annual percentage rate (APR), and wait an additional three days before closing the loan, if a change occurs that makes the APR in the early disclosures inaccurate beyond a specified tolerance. The amendments allow a consumer to expedite a loan closing in order to address a personal financial emergency, such as foreclosure. The amendments are effective July 30, 2009.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

[Docket No. R-1364]

On *July 15, 2009,* the Board approved an interim final rule with request for comment to implement certain provisions of the Credit Card Accountability Responsibility and Disclosure Act. The interim final rule requires creditors to provide written notice to consumers 45 days before increasing an APR on a credit card account or making a significant change to the terms of an account. Creditors must also inform consumers, in the same notice, of their right to cancel the account before the increase or change goes into effect. If a consumer does so, the creditor is generally prohibited from applying the increase or change to the account. In addition, creditors must generally mail or deliver periodic statements for credit cards and other open-end consumer credit accounts at least 21 days before payment is due. The interim final rule is effective August 20, 2009.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

[Docket No. R-1353]

On *July 27, 2009,* the Board approved final amendments to revise the disclosure requirements for private education loans, consistent with the requirements of the Higher Education Opportunity Act. Under the amendments, creditors that extend loans expressly for postsecondary educational expenses must provide disclosures about a loan's terms and features on or with the loan application and must disclose information about federal student loan programs that may offer less costly alternatives. Creditors must also provide additional disclosures when a loan is approved and when it is consummated. The new disclosure requirements do not apply to education loans made, insured, or guaranteed by the federal government, or in certain other situations (such as a credit card advance used to fund educational expenses). The amendments also include restrictions on using the name, emblem, or mascot of an educational institution in a way that implies the institution endorses a creditor's loans. The amendments, which include model disclosure forms, are effective September 14, 2009, and compliance is mandatory February 14, 2010.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

[Docket R-1378]

On *November 10, 2009,* the Board approved an interim final rule with request for comment to implement a requirement in the Helping Families Save Their Homes Act that consumers receive written notice after their mortgage loan has been sold or transferred. Under the act, a purchaser or assignee that acquires a mortgage loan must provide the required disclosures in writing within 30 days. The interim final rule is effective November 20, 2009, and compliance is mandatory January 19, 2010.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Regulation GG
Prohibition on Funding of Unlawful Internet Gambling

[Docket No. R-1298]

On *November 25, 2009,* the Board, acting jointly with the Department of the Treasury, approved a final rule to extend the compliance date for the joint regulation implementing certain provisions of the Unlawful Internet Gambling Enforcement Act by six months, to June 1, 2010.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Policy Statements and Other Actions

Homeownership Preservation Policy for Residential Mortgage Assets

On *January 23, 2009,* the Board approved a policy, developed pursuant to section 110 of the Emergency Economic Stabilization Act, to help prevent avoidable foreclosures on residential mortgage assets that are subject to section 110 and that are owned or controlled by a Reserve Bank. The Board also voted to voluntarily apply the policy to the residential mortgage assets held by the Maiden Lane limited liability companies, which were formed by the Federal Reserve Bank of New York to facilitate the acquisition of The Bear Stearns Companies, Inc. by JPMorgan Chase & Co. and to help stabilize the American International Group, Inc.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh and Duke.

Interagency Questions and Answers Regarding Flood Insurance

[Docket No. R-1311]

On *July 14, 2009,* the Board, acting with the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, Office of Thrift Supervision, National Credit Union Administration, and Farm Credit Administration, approved final revised Interagency Questions and Answers Regarding Flood Insurance. The questions and answers are intended to help financial institutions meet their responsibilities under federal flood insurance legislation and to increase public understanding of flood insurance regulation. The revised questions and answers, which supplement other guidance or interpretations issued by the agencies and the Federal Emergency Management Agency, are effective September 21, 2009, and supersede the agencies' questions and answers issued in 1997. (The Board also approved the issuance of five proposed new questions and answers for public comment.)

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Maximum Maturity of Primary Credit Loans

On *November 12, 2009,* the Board approved a reduction in the maximum maturity of primary credit loans at the discount window for depository institutions from 90 days to 28 days, effective January 14, 2010. Before August 2007, the maximum available term of primary credit was generally overnight. The Federal Reserve lengthened the maximum maturity to 30 days (on August 17, 2007) and then to 90 days (on March 16, 2008) in order to enhance banks' access to term funds and thus support their ability to lend to households and businesses.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Policy Governing Eligibility, Qualifications, and Rotation for Directors of Federal Reserve Banks and Their Branches

On *November 17, 2009,* the Board approved revisions to its eligibility, qualifications, and rotation policy for Federal Reserve Bank and Branch directors. The revisions address situations in which previously permissible affiliations or stockholdings may become impermissible for Class B and Class C directors, as a result of a company's change in character. (Class B and Class C directors represent the public and may not be an officer, a director, or an employee of a bank; in addition, Class C directors may not own stock in a bank.) If a Class B or Class C director is affiliated with a company (an officer, a director, or an employee of a company) that becomes a bank holding company or that otherwise becomes an impermissible affiliation, the director must either resign from the affiliation or resign from the Reserve Bank's board within 60 days of the earlier of the date that (1) the director becomes aware of the impermissible affiliation or (2) the Board informs the Reserve Bank of the change in character of the company. A Class C director who holds stock in a company that becomes a bank holding company or who holds stock that otherwise becomes an impermissible holding must either divest the stock or resign from the Reserve Bank's board within 60 days of the earlier of the date that (1) the director becomes aware of the impermissible stockholding or (2) the Board informs the Reserve Bank of the change in character of the company. The revisions also clarify the rules regarding a Class C director's indirect ownership in a financial stock issuer.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Duke and Tarullo. Absent and not voting: Governor Warsh.

Special Liquidity Facilities and Other Initiatives

The Board modified certain aspects of the special liquidity facilities and other initiatives that were previously implemented to promote financial stability and support critical institutions. For more information on the establishment and purposes of the facilities and initiatives discussed in this section, see the Board's *2008 Annual Report.*

Special Liquidity Facilities

On *January 27, 2009,* the Board extended its authorizations for the following facilities until October 30, 2009: Primary Dealer Credit Facility (PDCF), Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), Commercial Paper Funding Facility (CPFF), and Money Market Investor Funding Facility (MMIFF). (On *January 7, 2009,* the Board had announced changes to the MMIFF, including its economic parameters and the set of eligible investors for the facility.) The Board and the Federal Open Market Committee (FOMC) approved extending their authorizations for the Term Securities Lending Facility (TSLF) until October 30, 2009. All of the extensions were subject to the same collateral, interest rate, and other conditions previously established. The facilities had been scheduled to expire on April 30, 2009. (Further extensions are discussed in this section.)

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh and Duke.

On *June 23, 2009,* the Board extended its authorizations for the following facilities until February 1, 2010: AMLF, CPFF, and PDCF. The Board and the FOMC approved extending their authorizations for the TSLF until February 1, 2010. All of the extensions were subject to the same collateral, interest rate, and other conditions previously established. The Board reaffirmed that its authorization for the MMIFF would expire on October 30, 2009. The Board also trimmed the size and changed the terms of some facilities, in light of improving financial conditions and reduced usage of the facilities. Specifically, the Board reduced the amounts auctioned at biweekly Term Auction Facility (TAF) auctions from $150 billion to $125 billion, effective July 13, 2009, and stated that TAF funding may be reduced further, if warranted by market conditions. (See "Discount Rates for Depository Institutions in 2009" for further discussion of the TAF.) The Board and the FOMC suspended TSLF auctions backed by schedule 1 collateral (Treasury, agency-debt, and agency-guaranteed mortgage-backed securities), effective July 1, 2009, and the TSLF Options Program (TOP), effective with the maturity of outstanding June TOP options. The Board and the FOMC also reduced the frequency and size of TSLF auctions backed by schedule 2 collateral (schedule 1 collateral and investment-grade corporate, municipal, mortgage-backed, and asset-backed securities) from every two weeks to every four weeks, in amounts of $75 billion, and stated that amounts auctioned under the TSLF may be reduced further, if warranted by market conditions.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

NOTE: On *September 24, 2009,* the Board announced reductions in the amounts of 84-day TAF auctions, as well as reductions in the maturities of those auctions. The Board and the FOMC also announced reductions in the amounts of schedule 2 TSLF auctions. On *December 16, 2009,* the Board and the FOMC announced that they anticipated the following facilities would expire on February 1, 2010: AMLF, CPFF, PDCF, and TSLF. The Board and the FOMC also announced that they expected the amounts provided under the TAF would continue to be scaled back in early 2010.

Term Asset-Backed Securities Loan Facility

The Board authorized the Term Asset-Backed Securities Loan Facility (TALF) in November 2008 in order to increase credit availability and support economic activity by facilitating the issuance of asset-backed securities (ABS) collateralized by consumer and small business loans. On *February 6* and *February 23, 2009,* the Board approved revisions to the TALF's terms and conditions, including interest rates on loans, collateral haircuts, a revised definition of eligible borrowers, and additional specifications for ABS collateral. (Unless otherwise indicated, Board actions on the TALF in 2009 were approved by the unanimous vote of Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.) On *March 3, 2009,* the Board and the Department of the Treasury (Treasury) announced the launch of the TALF for eligible holders of ABS backed by newly and recently originated auto, credit card, and student loans and by small business loans guaranteed by the Small Business Administration.

On *March 19, 2009,* the Board approved an expansion of the eligible collateral for loans extended under the TALF to include ABS backed by mortgage-servicing advances, loans or leases relating to business equipment, leases of vehicle fleets, and non-auto floorplan loans. In addition, the Board expanded the list of eligible auto-related receivables. ABS backed by mortgage-servicing advances were added to improve servicers' ability to work with homeowners to prevent avoidable foreclosures. The other new ABS categories complement the consumer and small business loan categories that were already eligible.

On *April 21, 2009,* the Board approved the establishment of two new interest rates for certain fixed-rate loans extended under the TALF that are collateralized by ABS with weighted average lives to maturity of less than two years and that do not benefit from a government guarantee. These new rates are based on one- and two-year London interbank offered (Libor) swap rates and are more closely matched to the duration of the underlying ABS collateral. The Board also announced other technical clarifications to the program.

On *April 30, 2009,* the Board approved an expansion of the eligible collateral for TALF loans to include newly issued commercial mortgage-backed securities (CMBS) and newly issued securities backed by insurance-premium-finance loans. The inclusion of newly issued CMBS as eligible collateral for TALF loans helps prevent defaults on economically viable commercial properties, increases the capacity of current holders of maturing mortgages to make additional loans, and facilitates the sale of distressed properties. The inclusion of insurance-premium ABS facilitates the flow of credit to small businesses. The Board also authorized TALF loans with maturities of five years to finance purchases of newly issued CMBS, ABS backed by student loans, and ABS backed by loans guaranteed by the Small Business Administration. In addition, some of the interest on collateral financed with a five-year loan may be diverted toward an accelerated repayment of the loan, especially in the fourth and fifth years.

On *May 18, 2009,* the Board approved an expansion of the eligible collateral for TALF loans to include certain high-quality CMBS issued before January 1, 2009 (legacy CMBS), in order to improve legacy CMBS markets and thereby facilitate the issuance of new CMBS, which in turn helps borrowers finance new purchases of commercial properties or refinance existing commercial mortgages on better terms.

On June 22, 2009, the Board approved (1) an alternate lending rate for

TALF-eligible collateral consisting of ABS that are collateralized by private student loans and have a prime-based coupon and (2) other clarifying and technical changes to the TALF's terms and conditions. The alternate lending rate was established to help make private student loans more affordable and more readily available.

Votes for this action: Chairman Bernanke and Governors Warsh, Duke, and Tarullo. Absent and not voting: Vice Chairman Kohn.

On June 30, 2009, the Board approved an increase in the administrative fee charged to TALF borrowers from 5 basis points to (1) 10 basis points for loans collateralized by ABS and (2) 20 basis points for loans collateralized by CMBS (newly issued and legacy).

On July 6, 2009, the Board approved an adjustment to the haircuts applied to any loans extended under TALF to Treasury-sponsored Public-Private Investment Funds (PPIFs). The haircuts were increased so that, if a PPIF borrowed from the TALF, the combined Treasury-supplied and TALF-supplied debt would be no greater than the total amount of TALF debt that would be available, leveraging the PPIF equity alone.

On *August 13, 2009,* the Board, acting with Treasury, approved an extension of the TALF through March 31, 2010, for TALF loans against newly issued ABS and eligible legacy CMBS. Because new CMBS transactions can take more time to arrange, TALF loans against newly issued CMBS were extended through June 30, 2010. TALF loans had been previously authorized through December 31, 2009.

On *September 29, 2009,* the Board approved an enhanced credit review process for TALF-eligible ABS to help ensure that TALF collateral complies with the Federal Reserve's high standards for credit quality, transparency, and simplicity of structure.

NOTE: On *December 16, 2009,* the Board and the FOMC announced that the anticipated expiration dates for the TALF remained set at June 30, 2010, for loans backed by newly issued CMBS, and March 31, 2010, for loans backed by all other types of collateral.

Other Initiatives

Bank of America Corporation

On *January 15, 2009,* the Board, as part of a package of coordinated actions with the Department of the Treasury (Treasury) and the Federal Deposit Insurance Corporation (FDIC), authorized the Federal Reserve Bank of Richmond to enter into an agreement with Bank of America Corporation under which the Reserve Bank would make certain residual financing available to Bank of America in connection with a designated pool of approximately $118 billion in assets. (The Board also approved the issuance of a letter to the Secretary of the Treasury recommending that the Secretary invoke the systemic-risk exception to the least-cost-resolution requirements in the Federal Deposit Insurance Act to permit the FDIC to participate in the proposed agreement with Bank of America.) In September 2009, Bank of America paid an exit fee to terminate the term sheet with the Federal Reserve, Treasury, and the FDIC related to the residual financing arrangement and related guarantee protections.

Votes for these actions: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Duke.

American International Group, Inc.

On *March 1, 2009,* the Board approved a restructuring of the government's assistance to American International Group, Inc. (AIG) that, together with new capital to be provided by Treasury, would help stabilize the company, enhance the company's capital and liquidity, and facilitate the orderly completion of AIG's global divestiture program. As part of the restructuring, the Board authorized the Federal Reserve Bank of New York to (1) exchange a portion of AIG's existing outstanding debt under the revolving credit facility for preferred equity interests in special-purpose vehicles (SPVs) that would hold all of the equity interest in two AIG insurance subsidiaries, (2) provide up to approximately $8.5 billion in new loans to SPVs established by domestic life insurance subsidiaries of AIG to facilitate the securitization of designated blocks of existing life insurance policies held by the parent insurance companies, and (3) modify the interest rate payable under the revolving credit facility. Upon completion of these transactions, the maximum amount available under the revolving credit facility would be reduced.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Treasury Legacy Loans Program

On September 9, 2009, the Board approved the issuance of a letter to the Secretary of the Treasury recommending that the Secretary invoke the systemic-risk exception in the Federal Deposit Insurance Act to allow the FDIC and Treasury to implement the Legacy Loans Program under which the FDIC would guarantee debt issued by certain special-purpose entities, including Public-Private Investment Funds, established to acquire legacy assets from banking organizations.

Votes for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Duke, and Tarullo.

Discount Rates for Depository Institutions in 2009

Under the Federal Reserve Act, the boards of directors of the Federal Reserve Banks must establish rates on discount window loans to depository institutions at least every 14 days, subject to review and determination by the Board of Governors.

Primary Credit

Primary credit, the Federal Reserve's main lending program for depository institutions, is extended at a rate above the federal funds rate target set by the Federal Open Market Committee (FOMC). It is typically made available, with minimal administration and for very short terms, as a backup source of liquidity to depository institutions that, in the judgment of the lending Federal Reserve Bank, are in generally sound financial condition. On March 16, 2008, the Board announced a temporary change to the Reserve Banks' discount window lending practices to allow the provision of term financing for as long as 90 days. On November 17, 2009, the Board announced a reduction in the maximum maturity of such financing to 28 days effective January 14, 2010.

Throughout 2009, the primary credit rate was ½ percent.[1]

Secondary and Seasonal Credit

Secondary credit is available in appropriate circumstances to depository institutions that do not qualify for primary credit. The secondary credit rate is set at a spread above the primary credit rate. Throughout 2009, the spread was set at 50 basis points.

Seasonal credit is available to smaller depository institutions to meet liquidity needs that arise from regular swings in their loans and deposits. The rate on seasonal credit is calculated every two weeks as an average of selected money-market yields, typically resulting in a rate close to the federal funds rate target.

At year-end, the secondary and seasonal credit rates were 1 percent and 0.15 percent, respectively.[2]

Term Auction Facility Credit

In December 2007, the Federal Reserve established a temporary Term Auction Facility (TAF). Under the TAF, the Federal Reserve auctions term funds to depository institutions that are in generally sound financial condition and are eligible to borrow under the primary credit program. The amount of each auction is determined in advance by the Federal Reserve, and the interest rate on TAF credit is determined by the bidding process as the rate at which all bids can be fulfilled, up to the maximum auction amount and subject to a minimum bid rate. Starting on January 12, 2009, the minimum bid rate was set at a level equal to the rate of interest that banks earn on excess reserve balances. Previously, the minimum bid rate for TAF auctions was determined based on a measure of the average expected overnight federal funds rate over the term of the credit being auctioned. At every TAF auction in 2009, the resulting interest rate on TAF credit was equal to the minimum bid rate, which remained at ¼ percent throughout the year.

The Federal Reserve conducted regular $150 billion auctions of 28- and 84-day TAF credit throughout the first half of 2009.[3] On June 25, 2009, in view of the improvement in financial market conditions and the associated decline in the demand for TAF funds, the Board announced a reduction in the amount auctioned to $125 billion and noted that TAF funding would be reduced gradually further if market conditions continued to improve. The amounts auctioned in August and September were reduced to $100 billion and $75 billion, respectively. On September 24, 2009, the Board announced that the amounts offered at auctions of 28-day credit would be maintained at $75 billion per auction to ensure that an adequate volume of funding was available in the period leading up to year-end and over year-end. The amounts offered at 84-day auctions were reduced to $50 billion effective in October and to $25 billion in November and December, and the maturities of those

1. The spread of the primary credit rate over the FOMC's target rate was ordinarily 100 basis points. In 2007, the Board approved a narrowing of this spread to 50 basis points and in 2008, approved a further narrowing to 25 basis points. Throughout 2009, the FOMC maintained a target range for the federal funds rate of 0 to ¼ percent.

2. For current and historical discount rates, see www.frbdiscountwindow.org/.

3. For more information on TAF auctions, including minimum bid rates and the auction-determined rates on TAF credit, see federalreserve.gov/monetarypolicy/taf.htm.

operations were aligned with the maturity dates in the cycle for 28-day funds. With the completion of that transition, the auction schedule for 2010 was converted to a single cycle of 28-day funds offered every 28 days. On December 16, 2009, the Federal Reserve indicated that it expected that amounts provided under the Term Auction Facility would continue to be scaled back in early 2010.

Votes on Changes to Discount Rates for Depository Institutions

About every two weeks during 2009, the Board approved proposals by the 12 Reserve Banks to maintain the formulas for computing the secondary and seasonal credit rates as well as the auction method by which the TAF credit rate is set. In 2009, the Board did not approve any changes in the primary credit rate. ■

Minutes of Federal Open Market Committee Meetings

The policy actions of the Federal Open Market Committee, contained in the minutes of its meetings, are presented in the Annual Report of the Board of Governors pursuant to the requirements of section 10 of the Federal Reserve Act. That section provides that the Board shall keep a complete record of the actions taken by the Board and by the Federal Open Market Committee on all questions of policy relating to open market operations, that it shall record therein the votes taken in connection with the determination of open market policies and the reasons underlying each policy action, and that it shall include in its annual report to Congress a full account of such actions.

The minutes of the meetings contain the votes on the policy decisions made at those meetings as well as a summary of the information and discussions that led to the decisions. In addition, four times a year, starting with the October 2007 Committee meeting, a Summary of Economic Projections is published as an addendum to the minutes. The descriptions of economic and financial conditions in the minutes and the Summary of Economic Projections are based solely on the information that was available to the Committee at the time of the meetings.

Members of the Committee voting for a particular action may differ among themselves as to the reasons for their votes; in such cases, the range of their views is noted in the minutes. When members dissent from a decision, they are identified in the minutes and a summary of the reasons for their dissent is provided.

Policy directives of the Federal Open Market Committee are issued to the Federal Reserve Bank of New York as the Bank selected by the Committee to execute transactions for the System Open Market Account. In the area of domestic open market operations, the Federal Reserve Bank of New York operates under instructions from the Federal Open Market Committee that take the form of an Authorization for Domestic Open Market Operations and a Domestic Policy Directive. (A new Domestic Policy Directive is adopted at each regularly scheduled meeting.) In the foreign currency area, the Federal Reserve Bank of New York operates under an Authorization for Foreign Currency Operations, a Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations. Changes in the instruments during the year are reported in the minutes for the individual meetings.[1]

1. As of January 1, 2009, the Federal Reserve Bank of New York was operating under the Domestic Policy Directive approved at the December 15–16, 2008, Committee meeting and the Authorization for Foreign Currency Operations approved by notation vote on September 21, 2008. The other policy instruments (the Authorization for Domestic Open Market Operations, the Foreign Currency Directive, and Procedural Instructions with Respect to Foreign Currency Operations) in effect as of January 1, 2009, were approved at the January 29–30, 2008, meeting.

Meeting Held on January 27–28, 2009

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, January 27, 2009, at 1:30 p.m. and continued on Wednesday, January 28, 2009, at 9:00 a.m.

Present:

Mr. Bernanke, Chairman
Mr. Dudley, Vice Chairman
Ms. Duke
Mr. Evans
Mr. Kohn
Mr. Lacker
Mr. Lockhart
Mr. Warsh
Ms. Yellen

Mr. Bullard, Ms. Cumming, Mr. Hoenig, Ms. Pianalto, and Mr. Rosengren, Alternate Members of the Federal Open Market Committee

Messrs. Fisher, Plosser, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis, respectively

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Mr. Luecke, Assistant Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Ashton,[2] Assistant General Counsel
Mr. Sheets, Economist
Mr. Stockton, Economist

Messrs. Altig, Clouse, Connors, Kamin, Slifman, Tracy, and Wilcox, Associate Economists

Ms. Mosser, Temporary Manager, System Open Market Account

Ms. Johnson,[3] Secretary of the Board, Office of the Secretary, Board of Governors

Mr. Frierson,[3] Deputy Secretary, Office of the Secretary, Board of Governors

Mr. Struckmeyer, Deputy Staff Director, Office of Staff Director for Management, Board of Governors

Ms. Bailey, Deputy Director, Division of Banking Supervision and Regulation, Board of Governors

Mr. English, Deputy Director, Division of Monetary Affairs, Board of Governors

Mr. Blanchard, Assistant to the Board, Office of Board Members, Board of Governors

Messrs. Reifschneider and Wascher, Associate Directors, Division of Research and Statistics, Board of Governors

Mr. Levin, Associate Director, Division of Monetary Affairs, Board of Governors

Ms. Shanks,[4] Associate Secretary, Office of the Secretary, Board of Governors

Mr. Reeve, Deputy Associate Director, Division of International Finance, Board of Governors

Mr. Sichel, Deputy Associate Director, Division of Research and Statistics, Board of Governors

Mr. Meyer, Senior Adviser, Division of Monetary Affairs, Board of Governors

Mr. Oliner, Senior Adviser, Division of Research and Statistics, Board of Governors

Ms. Dynan, Assistant Director, Division of Research and Statistics, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

2. Attended Wednesday's session only.
3. Attended portion of the meeting that was a joint session of the Board and the FOMC.
4. Attended portion of the meeting on Tuesday that was a joint session of the Board and the FOMC.

Ms. Kusko, Senior Economist, Division of Research and Statistics, Board of Governors

Mr. Gust, Senior Economist, Division of International Finance, Board of Governors

Messrs. Driscoll and King, Economists, Division of Monetary Affairs, Board of Governors

Ms. Beattie,[3] Assistant to the Secretary, Office of the Secretary, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Ms. Green, First Vice President, Federal Reserve Bank of Richmond

Messrs. Fuhrer, Rosenblum, and Sniderman, Executive Vice Presidents, Federal Reserve Banks of Boston, Dallas, and Cleveland, respectively

Messrs. Hilton and Krane, Mses. Mester and Perelmuter, Messrs. Rasche, Rudebusch, and Sellon, Senior Vice Presidents, Federal Reserve Banks of New York, Chicago, Philadelphia, New York, St. Louis, San Francisco, and Kansas City, respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

Mr. Hetzel, Senior Economist, Federal Reserve Bank of Richmond

In the agenda for this meeting, it was reported that advices of the election of the following members and alternate members of the Federal Open Market Committee for a term beginning January 27, 2009, had been received and that these individuals had executed their oaths of office.

The elected members and alternate members were as follows:

William C. Dudley, President of the Federal Reserve Bank of New York, with Christine M. Cumming, First Vice President of the Federal Reserve Bank of New York, as alternate.

Jeffrey M. Lacker, President of the Federal Reserve Bank of Richmond, with Eric C. Rosengren, President of the Federal Reserve Bank of Boston, as alternate.

Charles L. Evans, President of the Federal Reserve Bank of Chicago, with Sandra Pianalto, President of the Federal Reserve Bank of Cleveland, as alternate.

Dennis P. Lockhart, President of the Federal Reserve Bank of Atlanta, with James B. Bullard, President of the Federal Reserve Bank of St. Louis, as alternate.

Janet L. Yellen, President of the Federal Reserve Bank of San Francisco, with Thomas M. Hoenig, President of the Federal Reserve Bank of Kansas City, as alternate.

Annual Organizational Matters

By unanimous vote, the following officers of the Federal Open Market Committee were selected to serve until the selection of their successors at the first regularly scheduled meeting of the Committee in 2010:

Ben S. Bernanke	Chairman
William C. Dudley	Vice Chairman
Brian F. Madigan	Secretary and Economist
Deborah J. Danker	Deputy Secretary
Matthew M. Luecke	Assistant Secretary
David W. Skidmore	Assistant Secretary
Michelle A. Smith	Assistant Secretary
Scott G. Alvarez	General Counsel
Thomas C. Baxter, Jr.	Deputy General Counsel
Richard M. Ashton	Assistant General Counsel
D. Nathan Sheets	Economist
David J. Stockton	Economist

David E. Altig, James A. Clouse, Thomas A. Connors, Steven B. Kamin, Lawrence Slifman, Daniel G. Sullivan, Joseph S. Tracy, John A. Weinberg, David W. Wilcox, and John C. Williams, Associate Economists

By unanimous vote, the Committee adopted several minor amendments to its Program for Security of FOMC Information.

By unanimous vote, the Federal Reserve Bank of New York was selected to execute transactions for the System Open Market Account.

Secretary's note: The Chairman reported that prior to the meeting he had used his authority under the Committee's Rules of Organization to appoint Ms. Mosser as Manager of the System Open Market Account until the Committee selects a replacement manager.

By unanimous vote, the Committee approved the Authorization for Foreign Currency Operations (shown below) with a clerical amendment that combined the list of currencies in 1.A approved at the January 2008 meeting with the five additional currencies that were approved by the Committee in September and October 2008 in connection with temporary reciprocal currency arrangements:

Authorization for Foreign Currency Operations (Amended January 27, 2009)

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, for System Open Market Account, to the extent necessary to carry out the Committee's foreign currency directive and express authorizations by the Committee pursuant thereto, and in conformity with such procedural instructions as the Committee may issue from time to time:

A. To purchase and sell the following foreign currencies in the form of cable transfers through spot or forward transactions on the open market at home and abroad, including transactions with the U.S. Treasury, with the U.S. Exchange Stabilization Fund established by Section 10 of the Gold Reserve Act of 1934, with foreign monetary authorities, with the Bank for International Settlements, and with other international financial institutions:

Australian dollars	Mexican pesos
Brazilian reais	New Zealand dollars
Canadian dollars	Norwegian kroner
Danish kroner	Pounds sterling
Euro	Singapore dollars
Japanese yen	Swedish kronor
Korean won	Swiss francs

B. To hold balances of, and to have outstanding forward contracts to receive or to deliver, the foreign currencies listed in paragraph A above.

C. To draw foreign currencies and to permit foreign banks to draw dollars under the reciprocal currency arrangements listed in paragraph 2 below, provided that drawings by either party to any such arrangement shall be fully liquidated within 12 months after any amount outstanding at that time was first drawn, unless the Committee, because of exceptional circumstances, specifically authorizes a delay.

D. To maintain an overall open position in all foreign currencies not exceeding $25.0 billion. For this purpose, the overall open position in all foreign currencies is defined as the sum (disregarding signs) of net positions in individual currencies, excluding changes in dollar value due to foreign exchange rate movements and interest accruals. The net position in a single foreign currency is defined as holdings of balances in that currency, plus outstanding contracts for future receipt, minus outstanding contracts for future delivery of that currency, i.e., as the sum of these elements with due regard to sign.

2. The Federal Open Market Committee directs the Federal Reserve Bank of New York to maintain reciprocal currency arrangements ("swap" arrangements) for the System Open Market Account for periods up to a maximum of 12 months with the following foreign banks, which are among those designated by the Board of Governors of the Federal Reserve System under Section 214.5 of Regulation N, Relations with Foreign Banks and Bankers, and with the approval of the Committee to renew such arrangements on maturity:

Foreign bank	Amount of arrangement (millions of dollars equivalent)
Bank of Canada	2,000
Bank of Mexico	3,000

Any changes in the terms of existing swap arrangements, and the proposed terms of any new arrangements that may be authorized, shall be referred for review and approval to the Committee.

3. All transactions in foreign currencies undertaken under paragraph 1.A. above shall, unless otherwise expressly authorized by the Committee, be at prevailing market rates. For the purpose of providing an investment return on System holdings of foreign currencies or for the purpose of adjusting interest rates paid or received in connection with swap drawings, transactions with foreign central banks may be undertaken at non-market exchange rates.

4. It shall be the normal practice to arrange with foreign central banks for the coordination of foreign currency transactions. In making operating arrangements with foreign central banks on System holdings of foreign currencies, the Federal Reserve Bank of New York shall not commit itself to maintain any specific balance, unless authorized by the Federal Open Market Committee. Any agreements or understandings concerning the administration of the accounts maintained by the Federal Reserve Bank of New York with the foreign banks designated by the Board of Governors under Section 214.5 of Regulation N shall be referred for review and approval to the Committee.

5. Foreign currency holdings shall be invested to ensure that adequate liquidity is maintained to meet anticipated needs and so that each currency portfolio shall generally have an average duration of no more than 18 months (calculated as Macaulay duration). Such investments may include buying or selling outright obligations of, or fully guaranteed as to principal and interest by, a foreign government or agency thereof; buying such securities under agreements for repurchase of such securities; selling such securities under agreements for the resale of such securities; and holding various time and other deposit accounts at foreign institutions. In addition, when appropriate in connection with arrangements to provide investment facilities for foreign currency holdings, U.S. Government securities may be purchased from foreign central banks under agreements for repurchase of such securities within 30 calendar days.

6. All operations undertaken pursuant to the preceding paragraphs shall be reported promptly to the Foreign Currency Subcommittee and the Committee. The Foreign Currency Subcommittee consists of the Chairman and Vice Chairman of the Committee, the Vice Chairman of the Board of Governors, and such other member of the Board as the Chairman may designate (or in the absence of members of the Board serving on the Subcommittee, other Board members designated by the Chairman as alternates, and in the absence of the Vice Chairman of the Committee, the Vice Chairman's alternate). Meetings of the Subcommittee shall be called at the request of any member, or at the request of the Manager, System Open Market Account ("Manager"), for the purposes of reviewing recent or contemplated operations and of consulting with the Manager on other matters relating to the Manager's responsibilities. At the request of any member of the Subcommittee, questions arising from such reviews and consultations shall be referred for determination to the Federal Open Market Committee.

7. The Chairman is authorized:

A. With the approval of the Committee, to enter into any needed agreement or understanding with the Secretary of the Treasury about the division of responsibility for foreign currency operations between the System and the Treasury;

B. To keep the Secretary of the Treasury fully advised concerning System foreign currency operations, and to consult with the Secretary on policy matters relating to foreign currency operations;

C. From time to time, to transmit appropriate reports and information to the National Advisory Council on International Monetary and Financial Policies.

8. Staff officers of the Committee are authorized to transmit pertinent information on System foreign currency operations to appropriate officials of the Treasury Department.

9. All Federal Reserve Banks shall participate in the foreign currency operations for System Account in accordance with paragraph 3G(1) of the Board of Governors' Statement of Procedure with Respect to Foreign Relationships of Federal Reserve Banks dated January 1, 1944.

By unanimous vote, the Foreign Currency Directive was reaffirmed in the form shown below:

Foreign Currency Directive (Reaffirmed January 27, 2009)

1. 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.

2. To achieve this end the System shall:

A. Undertake spot and forward purchases and sales of foreign exchange.

B. Maintain reciprocal currency ("swap") arrangements with selected foreign central banks.

C. Cooperate in other respects with central banks of other countries and with international monetary institutions.

3. Transactions may also be undertaken:

A. To adjust System balances in light of probable future needs for currencies.

B. To provide means for meeting System and Treasury commitments in particular currencies, and to facilitate operations of the Exchange Stabilization Fund.

C. For such other purposes as may be expressly authorized by the Committee.

4. System foreign currency operations shall be conducted:

A. In close and continuous consultation and cooperation with the United States Treasury;

B. In cooperation, as appropriate, with foreign monetary authorities; and

C. In a manner consistent with the obligations of the United States in the International Monetary Fund regarding exchange arrangements under IMF Article IV.

By unanimous vote, the Committee approved the Procedural Instructions with Respect to Foreign Currency Operations, with the addition of the clarifying phrase "unless otherwise directed by the Committee" in the first sentence:

Procedural Instructions with respect to Foreign Currency Operations (Amended January 27, 2009)

In conducting operations pursuant to the authorization and direction of the Federal Open Market Committee as set forth in the Authorization for Foreign Currency Operations and the Foreign Currency Directive, the Federal Reserve Bank of New York, through the Manager, System Open Market Account ("Manager"), shall be guided by the following procedural understandings with respect to consultations and clearances with the Committee, the Foreign Currency Subcommittee, and the Chairman of the Committee, unless otherwise directed by the Committee. All operations undertaken pursuant to such clearances shall be reported promptly to the Committee.

1. The Manager shall clear with the Subcommittee (or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $300 million on any day or $600 million since the most recent regular meeting of the Committee.

B. Any operation that would result in a change on any day in the System's net position in a single foreign currency exceeding $150 million, or $300 million when the operation is associated with repayment of swap drawings.

C. Any operation that might generate a substantial volume of trading in a particular currency by the System, even though the change in the System's net position in that currency might be less than the limits specified in 1.B.

D. Any swap drawing proposed by a foreign bank not exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

2. The Manager shall clear with the Committee (or with the Subcommittee, if the Subcommittee believes that consultation with the full Committee is not feasible in the time available, or with the Chairman, if the Chairman believes that consultation with the Subcommittee is not feasible in the time available):

A. Any operation that would result in a change in the System's overall open position in foreign currencies exceeding $1.5 billion since the most recent regular meeting of the Committee.

B. Any swap drawing proposed by a foreign bank exceeding the larger of (i) $200 million or (ii) 15 percent of the size of the swap arrangement.

3. The Manager shall also consult with the Subcommittee or the Chairman about proposed swap drawings by the System and about any operations that are not of a routine character.

By unanimous vote, the Committee approved several amendments to the Authorization for Domestic Open Market Operations (shown below). The amendments consolidate language authorizing repurchase agreements and reverse repurchase agreements into one paragraph, add a paragraph authorizing the use of agents to execute transactions in certain mortgage-backed securities (MBS), and add language to the final paragraph that reflects the Committee's current focus on using the composition and size of the Federal Reserve's balance sheet as instruments of monetary policy. The final paragraph now specifies that decisions to make material changes in the composition and size of the portfolio of assets held in the System Open Market Account during the period between meetings of the Federal Open Market Committee will be made in the same manner as decisions to change the intended level of the federal funds rate during the intermeeting period:

Authorization for Domestic Open Market Operations (Amended January 27, 2009)

1. The Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York, to the extent necessary to carry out the most recent domestic policy directive adopted at a meeting of the Committee:

A. To buy or sell U.S. Government securities, including securities of the Federal Financing Bank, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States in the open market, from or to securities dealers and foreign and international accounts maintained at the Federal Reserve Bank of New York, on a cash, regular, or deferred delivery basis, for the System Open Market Account at market prices, and, for such Account, to exchange maturing U.S. Government and Federal agency securities with the Treasury or the individual agencies or to allow them to mature without replacement;

B. To buy or sell in the open market U.S. Government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, for the System Open Market Account under agreements to resell or repurchase such securities or obligations (including such transactions as are commonly referred to as repo and reverse repo transactions) in 65 business days or less, at rates that, unless otherwise expressly authorized by the Committee, shall be determined by competitive bidding, after applying reasonable limitations on the volume of agreements with individual counterparties.

2. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to use agents in agency MBS-related transactions.

3. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. Government securities held in the System Open Market Account to dealers at rates that shall be determined by competitive bidding. The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York.

4. In order to ensure the effective conduct of open market operations, while assisting in the provision of short-term investments for foreign and international accounts maintained at the Federal Reserve Bank of New York and accounts maintained at the Federal Reserve Bank of New York as fiscal agent of the United States pursuant to Section 15 of the Federal Reserve Act, the Federal Open Market Committee authorizes and directs the Federal Reserve Bank of New York (a) for System Open Market Account, to sell U.S. Government securities to such accounts on the bases set forth in paragraph 1.A under agreements providing for the resale by such accounts of those securities in 65 business days or less on terms comparable to those available on such transactions in the market; and (b) for New York Bank account, when appropriate, to undertake with dealers, subject to the conditions imposed on purchases and sales of securities in paragraph l.B, repurchase agreements in U.S. Government and agency securities, and to arrange corresponding sale and repurchase agreements between its own account and such foreign, international, and fiscal agency accounts maintained at the Bank. Transactions undertaken with such accounts under the provisions of this paragraph may provide for a service fee when appropriate.

5. In the execution of the Committee's decision regarding policy during any intermeeting period, the Committee authorizes and directs the Federal Reserve Bank of New York, upon the instruction of the Chairman of the Committee, to adjust somewhat in exceptional circumstances the degree of pressure on reserve positions and hence the intended federal funds rate and to take actions that result in material changes in the composition and size of the assets in the System Open Market Account other than those anticipated by the Committee at its most recent meeting. Any such adjustment shall be made in the context of the Committee's discussion and decision at its most recent meeting and the Committee's long-run objectives for price stability and sustainable economic growth, and shall be based on economic, financial, and monetary developments during the intermeeting period. Consistent with Committee practice, the Chairman, if feasible, will consult with the Committee before making any adjustment.

In light of its program to purchase large quantities of agency debt and mortgage-backed securities, the Committee voted to suspend temporarily the Guidelines for the Conduct of System Operations in Federal Agency Issues (last amended January 28, 2003). Mr. Lacker dissented, stating that he views targeted purchases of agency debt and mortgage-backed securities as distorting credit markets and would prefer that the Desk instead purchase Treasury securities.

The remainder of the Committee's meeting was conducted as a joint meeting with the Board of Governors in order to facilitate policy discussion of developments with regard to the System's liquidity facilities and balance sheet during the intermeeting period and to consider the need for changes in the System's approach to using those tools.

Market Developments and Open Market Operations

The Manager of the System Open Market Account reported on recent developments in domestic and foreign financial markets. The Manager also reported on System open market operations in Treasury securities and in agency debt and mortgage-backed securities during the period since the Committee's December 15–16 meeting. By unanimous vote, the Committee ratified these transactions. There were no open market operations in foreign currencies for the System's account during the period since the Committee's December 15–16 meeting.

Meeting participants discussed the potential benefits of conducting open market purchases of a substantial quantity of longer-term Treasury securities for the System Open Market Account. Participants generally agreed that purchasing such securities could be a useful adjunct to other monetary policy tools in some circumstances. One participant preferred to begin purchasing Treasury securities immediately, as a way to increase the monetary base, in lieu of expanding programs that aim to support particular segments of the credit markets. Other participants were prepared to purchase longer-term Treasury securities if evolving circumstances were to indicate that such transactions would be particularly effective in improving conditions in private credit markets. However, they judged that purchases of longer-term Treasury securities would only modestly improve conditions in private credit markets at present, and that completing already-announced plans to purchase large quantities of agency debt and mortgage-backed securities and to support certain asset-backed securities markets was, in current circumstances, likely to be a more effective way to employ the Federal Reserve balance sheet to support credit flows to, and spending by, households and businesses.

System Liquidity Programs and Balance Sheet

Staff reported on developments in System liquidity programs and on changes in the System's balance sheet since the Committee's December 15–16 meeting. As of January 26, the System's total assets and liabilities stood at just under $2 trillion, about $300 billion less than on December 17, 2008. The drop, which resulted primarily from a decline in foreign central bank drawings on reciprocal currency arrangements and a reduction in issuers' sales of commercial paper to the Commercial Paper Funding Facility (CPFF), seemed to reflect some improvement in the functioning of global interbank markets and the commercial paper market after the year-end.

Most participants interpreted the evidence as indicating that credit markets still were not working well, and that the Federal Reserve's lending programs, asset purchases, and currency swaps were providing much-needed support to economic activity by reducing dislocations in financial markets, lowering the cost of credit, and facilitating the flow of credit to businesses and households. Several indicated that they expected the soon-to-be-implemented Term Asset-Backed Securities Loan Facility (TALF) to improve liquidity and reduce disruptions in the markets for securities backed by student loans, credit card receivables, auto loans, and small business loans guaranteed by the Small Business Administration; they also noted that it might become necessary to enhance or expand the TALF or other programs. However, in the view of one participant, financial markets—including those for asset-backed securities—were working reasonably well, given the current high level of pessimism and uncertainty about economic prospects and asset values, and the System's lending and asset-purchase programs were resulting in undesirable distortions in the allocation of credit. Others noted that such programs could have undesirable consequences if expanded too far or continued too long. Many participants agreed that it would be desirable for the System to develop additional measures of the effects of its programs, and they encouraged additional research on analytical frameworks that could inform Federal Reserve policy actions with respect to the size and composition of its balance sheet.

Several meeting participants noted that the expansion of the Federal Reserve's balance sheet along with continued growth of the money supply could help stabilize longer-run inflation expectations in the face of increasing economic slack and very low inflation in coming quarters. Over a longer horizon, however, the Federal Reserve will need to scale back its liquidity programs and the size of its balance sheet as the economy recovers, to avoid the risk of an unwanted increase in expected inflation and a buildup of inflation pressures. Participants observed that many of the Federal Reserve's liquidity programs are priced so that they will become unattractive to borrowers as conditions in financial markets improve; these programs will shrink automatically. In other cases, the Federal Reserve eventually may have to take a more active role in scaling back programs by adjusting their terms and conditions. More generally, the Federal Reserve may need to develop additional tools to manage the size of its balance sheet and the level of the federal funds rate as the economy recovers. As of late January, however, with financial conditions strained and the economic outlook weak, most participants agreed that the Committee should continue to focus on supporting the functioning of financial markets and stimulating the economy through purchases of agency debt and mortgage-backed securities and other measures—including the implementation of the TALF—that will keep the size of the Federal Reserve's balance sheet at a high level for some time.

Participants also discussed the advisability of extending the termination dates of a number of temporary liquidity facilities and reciprocal currency arrangements from April 30 to October 30, 2009. Participants generally were of the view that, despite modest improvements in some sectors, conditions in credit markets overall remained severely disrupted. Most expressed support for extending the termination dates in order to reassure market participants that the facilities would remain in place as a backstop to private-sector credit arrangements while financial conditions remained strained; they were prepared to extend the facilities beyond year-end if conditions warrant. Participants also noted that extending the termination date of these liquidity facilities to October 30 would not rule out the possibility of closing particular facilities sooner if improvements in financial conditions were to indicate they were no longer needed to support credit markets and economic activity and to help preserve price stability.

Following the discussion, the Committee voted unanimously to extend the termination dates of existing reciprocal currency arrangements and the Term Securities Lending Facility (TSLF) to October 30, 2009. The Board of Governors then voted unanimously to extend the termination dates of the TSLF, the Primary Dealer Credit Facility (PDCF), the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), the CPFF, and the Money Market Investor Funding Facility (MMIFF) to October 30, 2009.

Staff Review of the Economic and Financial Situation

The information reviewed at the meeting indicated a continued sharp contraction in real economic activity. Sales and starts of new homes remained on a steep downward trend, consumer spending continued its significant decline, the deterioration in business equipment investment intensified, and foreign demand weakened. Conditions in the labor market continued to deteriorate rapidly in December: Private payroll employment fell sharply, and the unemployment rate rose. Industrial production dropped more severely than in earlier months. Headline consumer prices fell in November and December, reflecting declines in consumer energy prices; core consumer prices were about flat in those months. While conditions in some financial markets showed limited improvement, extraordinary financial stresses remained apparent and credit conditions became still tighter for households and businesses.

Employment continued to contract. Private nonfarm payrolls fell sharply in December, with substantial losses over a wide range of industries. Indicators of job vacancies and hiring declined further, and layoffs continued to mount. The unemployment rate increased to 7.2 percent in December, the share of individuals working part time for economic reasons surged, and the labor force participation rate edged down for a second consecutive month.

In December, industrial production posted a sharp decline after falling substantially in November; the contraction was broad-based. The decrease in production of consumer goods reflected cutbacks in motor vehicle assemblies as well as in the output of consumer durable goods such as appliances, furniture, and carpeting. Output in high-tech sectors contracted in the fourth quarter, reflecting reduced production of semiconductors, communications equipment, and computers. The production of aircraft and parts recorded an increase in December after being held down in the autumn by a strike and by problems with some outsourced components. Available forward-looking indicators pointed to a further contraction in manufacturing output in coming months.

Real consumer spending appeared to decline sharply again in the fourth quarter, likely reflecting the combined effects of decreases in house and equity prices, a weakening labor market, and tight credit conditions. Real spending on goods excluding motor vehicles was estimated to have fallen noticeably in December, more than reversing an increase in November. Outlays on motor vehicles edged down in November and December following a sharper decline in October. Early indicators of spending in January pointed to continued soft demand. Readings on consumer sentiment remained at very low levels by historical standards through the end of 2008 and showed little improvement in early January.

Real residential construction contracted in November and December. Single-family housing starts dropped at a much faster rate in those months than they had in the first 10 months of the year. Multifamily starts also fell in those months, as did permit issuance for both categories. Housing demand remained very weak and, although the stock of unsold new single-family homes continued to move down in November, inventories of unsold homes remained elevated relative to the pace of sales. Sales of existing single-family homes dropped less than sales of new homes in November and turned up in December, but the relative strength in sales of existing homes appeared to be at least partly attributable to increases in foreclosure-related and other distressed sales. Although the interest rate on conforming 30-year fixed-rate mortgages declined markedly over the intermeeting period, the Senior Loan Officer Opinion Survey on Bank Lending Practices that was conducted in January indicated that banks had tightened lending standards on prime mortgage loans over the preceding three months.

The market for nonconforming loans remained severely impaired. Several indexes indicated that house prices continued to decline rapidly.

In the business sector, investment in equipment and software appeared to contract noticeably in the fourth quarter, with decreases registered in all major spending categories. In December, business purchases of autos and trucks moved down. Spending on high-tech capital goods appeared to decline in the fourth quarter. Orders and shipments for many types of equipment declined in October and November, and imports of capital goods dropped back in those months. Forward-looking indicators of investment in equipment and software pointed to likely further declines. Construction spending related to petroleum refining and power generation and distribution continued to increase briskly in the second half of 2008, responding to the surge in energy prices in the first half of that year, but real investment for many types of buildings stagnated or declined. Vacancy rates for office, retail, and industrial properties continued to move up in the fourth quarter, and the results of the January Senior Loan Officer Opinion Survey indicated that financing for new projects had become even more difficult to acquire.

Real nonfarm inventories (excluding motor vehicles) appeared to have fallen in the last few months of 2008. However, with sales declining even more sharply, the ratio of book-value inventories to sales increased in October and November.

The U.S. international trade deficit narrowed sharply in November, as a steep decline in imports outweighed a sizable drop in exports. Much of the fall in exports was attributable to a decline in exports of fuels, chemicals, and other industrial supplies, which in part reflected lower prices for these goods. All other major categories of exports moved down as well. More than half of the decline in imports was due to a decrease in imports of oil that mostly reflected a dramatic decrease in prices but also some reduction in volume. All other major categories of imports also recorded sizable decreases.

Economic activity in the advanced foreign economies appeared to contract sharply in the fourth quarter, as the pace of job losses rose and measures of consumer spending on durable goods and business spending on investment goods showed declines. In Japan and Europe, trade and industrial production dropped steeply, and measures of consumer and business sentiment declined. In Canada, employment fell markedly in November and December after edging up in October. Incoming data suggested that economic activity in the emerging market economies slowed significantly in the fourth quarter, with real gross domestic product (GDP) plunging in several Asian economies and appearing little changed in China. Industrial production, trade, and measures of consumer sentiment registered declines across many other countries in both emerging Asia and Latin America.

In the United States, overall personal consumption expenditure (PCE) prices were estimated to have fallen in December, largely reflecting significant reductions in energy prices. Increases in consumer food prices began to moderate toward the end of 2008. Excluding food and energy prices, PCE prices appeared to have decelerated over the final three months of the year. The moderation in core PCE prices was widespread across categories of goods and services. After rising rapidly during the first nine months of the year, producer prices excluding food and energy fell sharply in the last three months of 2008. Measures of longer-term inflation expectations edged up in early January, but remained lower than they had been in all but the last few weeks of 2008. In December, average hourly earnings moved up moderately.

The decisions of the Federal Open Market Committee (FOMC) at its December 15–16 meeting reportedly were more aggressive than investors had been expecting. Market participants reportedly were somewhat surprised both by the size of the reduction in the target federal funds rate, to a range of 0 to ¼ percent, and by the statements that policy rates would likely remain low for some time and that the FOMC might engage in additional nontraditional policy actions such as the purchase of longer-term Treasury securities. Over the intermeeting period, investors marked down their expectations for the path of the federal funds rate, as measured by money market futures rates. The path first moved down immediately after the December FOMC meeting. Later in the period, the policy path tilted lower in response to weaker-than-expected economic data releases and increased concerns about the health of some financial institutions. In contrast, yields on medium- and longer-term nominal Treasury coupon securities increased, on net, over the period. Yields dropped sharply following the release of the FOMC statement, reportedly in part because investors interpreted it as suggesting that the Federal Reserve might increase its holdings of longer-term Treasury securities. Those price movements were more than reversed after the turn of the year, despite the worsening economic outlook, apparently reflecting a waning of year-end safe-haven demands and an anticipation of substantially increased Treasury debt issuance to finance larger-than-expected deficits associated with the new Administration's economic stimulus plans. Although implied inflation compensation derived from Treasury Inflation-Protected Securities (TIPS) increased over the period, this increase reportedly was largely attributable to improved trading conditions in the TIPS market rather than upward revisions to inflation expectations.

Conditions in short-term funding markets showed some signs of easing, although significant stresses remained. The spreads of London interbank offered rates, or Libor, over comparable-maturity overnight index swap rates declined across most maturities over the period: The one-month spread fell to its lowest level since August 2007; the three-month spread also declined but remained elevated. Though depository institutions continued to make substantial use of the discount window, the amount of primary credit outstanding declined. Recent auctions of term funds under the Federal Reserve's Term Auction Facility were undersubscribed, although one auction following the year-end did see a relatively large number of bidders. The TSLF auctions were also undersubscribed. Use of the PDCF continued to fall significantly over the period.

Conditions in markets for repurchase agreements, or repos, also showed some signs of improvement. With the overnight Treasury general collateral repo rate near zero for much of the period, market participants reportedly were reluctant to lend Treasury collateral out of concern that counterparties might fail to return borrowed securities. However, the pace of delivery fails continued to run well below the high rates of September and October, reflecting in part reductions in transaction volumes as well as industry efforts to mitigate fails, including the January 5 recommendation of the Treasury Market Practices Group to implement a financial charge on settlement fails. Conditions in the market for repo transactions backed by agency debt and mortgage-backed securities also improved somewhat, with average bid-asked spreads declining from high levels.

The market for Treasury coupon securities showed signs of increased impairment late in 2008, followed by some improvement early in 2009. Trading volumes fell to very low levels at the end of 2008, although they recovered a bit after the end of the year. Bid-asked spreads in the on-the-run market declined sharply at the beginning of 2009 after having increased at the end of 2008. The on-the-run premium for the 10-year nominal Treasury note was little changed at very elevated levels over the intermeeting period. On balance, the Treasury market remained much less liquid than normal.

Treasury- and government-only money market mutual funds (MMMFs) faced pressures stemming from very low short-term interest rates, and many such funds reportedly had waived management fees in an effort to retain investors. By contrast, prime MMMFs had net inflows over the intermeeting period. The MMIFF continued to register no activity despite changes that eased some of the terms of the program. Market participants nonetheless pointed to the MMIFF as a potentially important backup facility.

Conditions in the commercial paper (CP) market improved over the intermeeting period, likely reflecting recent measures taken in support of this market, greater demand from institutional investors, and the passing of year-end. Yields and spreads on 30-day A1/P1 nonfinancial and financial CP as well as on asset-backed commercial paper (ABCP) declined modestly and remained low. Yields and spreads on 30-day A2/P2 CP, which is not eligible for purchase under the CPFF, dropped sharply after the beginning of the year as some institutional investors reportedly reentered the market. The dollar amounts of outstanding unsecured financial and nonfinancial CP and ABCP rose slightly, on net, over the intermeeting period. This small change was more than accounted for by the increase in CP held by the CPFF. In contrast, credit extended under the AMLF declined over the intermeeting period.

Liquidity in the corporate bond market improved over the intermeeting period, with increases in trading volume for both investment- and speculative-grade bonds and declines in bid-asked spreads for speculative-grade bonds. Yields and spreads on corporate bonds decreased noticeably, particularly for speculative-grade firms, but spreads remained high by historical standards. Gross issuance of bonds by nonfinancial investment-grade companies remained solid, but issuance of speculative-grade bonds was limited. Conditions in the leveraged loan market remained very poor and issuance of leveraged syndicated loans was also very weak. Secondary market prices for leveraged loans stayed near record lows and the average bid-asked spread in that market continued to be very wide. The market for commercial mortgage-backed securities (CMBS) continued to show signs of strain, with the CMBX index—an index based on credit default swap (CDS) spreads on AAA-rated CMBS—widening during the intermeeting period from already very elevated levels.

Broad equity market indexes fell over the intermeeting period. After improving during the early part of the intermeeting period, market sentiment toward financial firms appeared to worsen later in the period. Those firms substantially underperformed the broader market as a number of large and regional banks reported sizable losses stemming from weak trading results, asset write-downs, and additional increases in loan-loss provisions in anticipation of a further deterioration in credit quality. CDS spreads for U.S. bank holding companies rose sharply in mid-January to near their historical highs, and equity prices for such companies fell on net, ending the period below their November lows. A number of banking organizations issued debt through the FDIC's Temporary Liquidity Guarantee Program; spreads on such debt declined to levels close to those on agency debt. The Treasury's Troubled Asset Relief Program provided additional support to several banking institutions. In particular, to support financial market stability, the Treasury, the FDIC, and the Federal Reserve announced on January 16 that they had entered into an agreement with Bank of America to provide a package of guarantees, liquidity access, and capital. Developments at nonbank financial institutions were mixed. Equity prices of insurance companies edged down over the period, while their CDS spreads declined from extremely high levels. Hedge funds posted negative average returns in December.

Debt of the domestic nonfinancial sectors expanded at a somewhat faster pace in the fourth quarter of 2008 than in the first three quarters of the year. Borrowing by the federal government continued to surge, boosted by programs aimed at reducing financial market strains. Borrowing by state and local governments picked up as the conditions in municipal bond market improved somewhat. Household debt appeared to have contracted in the fourth quarter, with both mortgage and consumer credit sharply curtailed due to weak household spending and tight credit conditions. Business debt expanded only modestly, given the high cost of borrowing, tighter lending terms, and the deterioration in the macroeconomic environment.

Commercial bank credit fell for the second consecutive month in December. Commercial and industrial loans declined in November and December, likely reflecting a combination of tighter credit supply and reduced loan demand as well as some unwinding of the surge during September and October. The Senior Loan Officer Opinion Survey conducted in January indicated that banks had continued to tighten credit standards and terms on all major loan categories over the past three months. Survey respondents also indicated that they had reduced the size of credit lines for a wide range of existing business and household customers.

M2 expanded at a considerably more rapid pace in December than in previous months. Flows into both demand deposits and savings deposits surged, possibly reflecting a reallocation of wealth towards assets that had government insurance or guarantees. Small time deposits also increased strongly, as banks continued to bid aggressively for these deposits. Currency continued to grow briskly, apparently boosted by solid foreign demand for U.S. banknotes. In December, retail MMMF balances increased modestly after a decline in November.

Conditions in foreign financial markets were relatively calm over the intermeeting period, although concerns about bank earnings and the stability of the global banking system led to widespread declines in equity prices later in the period. Governments in major foreign economies initiated several actions aimed at strengthening the banking sector and easing credit market strains. Sovereign bond yields in the advanced foreign economies fell early in the period, likely reflecting declining inflation and expectations of lower policy rates, but moved up subsequently, perhaps in response to concerns about fiscal deficits. The dollar increased on balance against the currencies of major U.S. trading partners.

Staff Economic Outlook

In the forecast prepared for the meeting, the staff revised down its outlook for economic activity in the first half of 2009, as the implications of weaker-than-anticipated economic data releases more than offset an upward revision to the staff's assumption of the amount of forthcoming fiscal stimulus. Conditions in the labor market deteriorated sharply over the intermeeting period. Industrial production declined steeply, and household and business spending fell more than anticipated. Sales and starts of new homes remained on a steep downtrend. Foreign demand also was weaker than expected. Financial markets continued to be strained overall, credit remained unusually tight for both households and businesses, and equity prices had fallen further. The staff's projections of real GDP growth in the second half of 2009 and in 2010 were revised upward slightly, reflecting greater monetary and fiscal stimulus as well as the effects of more moderate oil prices and long-term interest rates, but they continued to show no more than a gradual economic recovery. The staff again expected that unemployment would rise substantially through the beginning of 2010 before edging down over the remainder of that year. Forecasts for core and overall PCE inflation in 2009 and 2010 were little changed, with growth in both core and overall PCE prices expected to be unusually low over the next few years in response to slack in resource utilization and relatively flat prices anticipated for many commodities and for imports.

Meeting Participants' Views and Committee Policy Action

In conjunction with this FOMC meeting, all meeting participants—the four members of the Board of Governors and the presidents of the twelve Federal Reserve Banks—provided projections for economic growth, the unemployment rate, and consumer price inflation for each year from 2009 through 2011. To provide the public with information about their views of likely longer-term economic trends, and as additional context for the Committee's monetary policy discussions, participants agreed to collect and publish, on a quarterly basis, projections of the longer-run values to which they expect these three variables to converge. Participants' projections through 2011, and for the longer-run, are described in the Summary of Economic Projections that is attached as an addendum to these minutes.

In their discussion of the economic and financial situation and the outlook for the economy, participants agreed that the economy had weakened further going into 2009. The incoming data, as well as information received from contacts in the business and banking communities, indicated a sharp and widespread economic contraction both domestically and abroad, reflecting in large part the adverse effects of the intensification of the financial crisis and the interaction between deteriorating economic and financial conditions. Participants generally saw credit conditions as extremely tight, with financial markets fragile and some parts of the banking sector under substantial stress. However, modest signs of improvement were evident in some financial markets—particularly those that were receiving support from Federal Reserve liquidity facilities and other government actions. Participants anticipated that a gradual recovery in U.S. economic activity would begin during the third or fourth quarter of this year as the economy begins to respond to fiscal stimulus, relatively low energy prices, and continuing efforts to stabilize the financial sector and increase the availability of credit. Several participants noted that firms' efforts to control inventories as sales declined had contributed to the rapid downturn in production and employment in recent quarters, but expected that the resulting absence of widespread inventory overhangs might spur a prompt pickup in production in many sectors later this year once sales begin to level out or turn up. Headline inflation would pick up some as the effects of previous declines in oil and other commodity prices wore off. But in an environment of considerable economic slack, little if any inflation pressure from energy or other import prices, and possible declines in inflation expectations, headline and core inflation were expected to be quite low for several years. Participants were, however, quite uncertain about the outlook. All but a few saw the risks to growth as tilted to the downside; in light of financial stresses and tight credit conditions, they saw a significant risk that the economic recovery would be both delayed and initially quite weak. In particular, most participants saw the renewed deterioration in the banking sector's financial condition as posing a significant downside risk to the economic outlook absent additional initiatives to stabilize the banking system.

Participants noted that consumers were continuing to cut back expenditures in response to sharply declining employment, further declines in wealth, and tighter credit conditions. Some participants mentioned that business contacts had indicated that firms were reducing payrolls aggressively and also freezing wages and salaries, further restricting growth in personal income and thus probably damping consumer spending. Looking ahead, participants anticipated that tax cuts and some other elements of the proposed fiscal stimulus package would add to after-tax incomes and thus boost consumer spending, though the magnitude of the impetus was far from clear. For example, unless the cuts were clearly perceived to be permanent, the boost to consumer spending might prove short-lived, as was the case with the tax rebates distributed in the spring of 2008.

Participants saw no indication that the housing sector was beginning to stabilize. Though sales of existing homes appeared to have flattened out, a large fraction of those transactions seemed to have resulted from foreclosures or other forced sales; moreover, new home sales, housing starts, and permits all continued to decline steeply. Lower house prices and mortgage rates had increased housing affordability, but concerns that house prices may fall further appeared to be holding back potential buyers.

The pace of commercial construction also had slowed. A number of participants expressed concern that the commercial real estate sector could deteriorate sharply in the months ahead. They noted that a large number of commercial real estate mortgages will come due at a time when banks likely will still be facing balance-sheet constraints, the ability to securitize commercial real estate mortgages may remain severely restricted, and vacancy rates in commercial properties could well be climbing. Some participants worried that the outcome could be an increase in defaults on commercial real estate mortgages and forced sales of commercial properties, which could push prices down further and generate additional losses on banks' commercial real estate loan portfolios. However, the commercial real estate sector had expanded more moderately during the recent expansion than during the expansion of the late 1980s, suggesting that the downturn in the current cycle could be milder than that seen in the early 1990s.

Participants also noted that other categories of business investment were contracting; they expected the rapid contraction to continue in coming quarters. Equipment investment had declined particularly sharply, reflecting weak sales, tighter credit, and substantial uncertainty about future economic conditions and government policies. Lower energy and commodity prices, while supporting consumer spending, had reduced investment in oil, gas, and mineral extraction. Outside of the agricultural sector, business contacts had reported sizable cutbacks in their planned capital expenditures for 2009.

State and local government budgets had come under significant pressure as the slowing economy led to declining revenues. Several participants noted that governments in their regions were responding by cutting spending rather than supplementing revenues. The fiscal stimulus bill, which was being considered by the Congress as the Committee met, would support state and local government spending as well as boost federal spending, helping to buoy demands for goods and services. Participants generally thought that fiscal stimulus was a necessary and important complement to the steps the Federal Reserve and other agencies were taking, and that it would help foster economic recovery, but had questions about the details of the proposed legislation and the extent to which it would boost demands for and production of goods and services.

Participants indicated they had been surprised by the speed and magnitude of the slowdown in economic growth abroad and the resulting drop in demand for U.S. exports. It was noted that the surprisingly sharp decline in both U.S. exports and imports might also reflect tight credit conditions, including the reduced availability of trade credit. Moreover, participants did not expect foreign economies to rebound quickly, suggesting that net exports would not provide much support for U.S. economic activity in coming quarters.

Participants agreed that inflation pressures had diminished appreciably in recent quarters, and they expected significantly lower headline and core inflation during the next few years than during recent years. Indeed, most anticipated that inflation will slow for a time to rates somewhat lower than those they judge consistent with the dual goals of price stability and maximum employment, initially reflecting the recent declines in the prices of energy and other commodities and later responding to several years of substantial economic slack. Many participants noted some risk of a protracted period of excessively low inflation, especially if inflation expectations were to move down in response to lower actual inflation and increasing economic slack, and a few even saw some risk of deflation. Several others, however, anticipated that longer-run inflation expectations would remain well anchored, supported in part by the Federal Reserve's aggressive expansion of its balance sheet and the resulting growth of the monetary base, and therefore thought it unlikely that inflation would decline below levels they saw as consistent with the dual goals of price stability and maximum employment. Moreover, some noted a risk that expected inflation might actually increase to an undesirably high level if the public does not understand that the Federal Reserve's liquidity facilities will be wound down and its balance sheet will shrink as economic and financial conditions improve.

Several participants indicated that they thought the FOMC should explore establishing quantitative guidelines or targets for a monetary aggregate, perhaps the growth rate of the monetary base or M2; in their view such guidelines would provide useful information to the public and help anchor inflation expectations. Others were skeptical that a single quantitative measure could adequately convey the Federal Reserve's current approach to monetary policy because the stimulative effect of the Federal Reserve's liquidity-providing and asset-purchase programs depends not only on the scale but also on the mix of lending programs and securities purchases. In addition, a few participants noted that the sizes of some Federal Reserve liquidity programs are determined by banks' and market participants' need to use those programs and thus will tend to increase when financial conditions worsen and shrink when financial conditions improve; the size and composition of the Federal Reserve's balance sheet needs to be able to adjust in response.

In their discussion of monetary policy for the intermeeting period, Committee members agreed that keeping the target range for the federal funds rate at 0 to ¼ percent would be appropriate. They also agreed to continue using liquidity and asset-purchase programs to support the functioning of financial markets and stimulate the economy. Members further agreed that these programs were likely to maintain the size of the Federal Reserve's balance sheet at a high level. Members noted that it may be necessary to expand these programs, but had somewhat different views about the best way of doing so. One member expressed the view that it would be best to expand holdings of U.S. Treasury securities rather than to expand targeted liquidity programs. All other members indicated that they thought it appropriate to continue the program of purchasing agency debt and mortgage-backed securities. Several expressed a willingness to expand the size and duration of those purchases in the near future; others stood ready to expand the program if conditions warrant but noted that the program had only recently been implemented and preferred to wait for more information about economic and financial developments and the program's effects before considering an expansion.

At the conclusion of the discussion, with Mr. Lacker dissenting, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase GSE debt and agency-guaranteed MBS during the intermeeting period with the aim of providing support to the mortgage and housing markets. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of conditions in primary mortgage markets and the housing sector. By the end of the second quarter of this year, the Desk is expected to purchase up to $100 billion in housing-related GSE debt and up to $500 billion in agency-guaranteed MBS. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the following statement to be released at 2:15 p.m.:

"The Federal Open Market Committee decided today to keep its target range for the federal funds rate at 0 to ¼ percent. The Committee continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time.

Information received since the Committee met in December suggests that the economy has weakened further. Industrial production, housing starts, and employment have continued to decline steeply, as consumers and businesses have cut back spending. Furthermore, global demand appears to be slowing significantly. Conditions in some financial markets have improved, in part reflecting government efforts to provide liquidity and strengthen financial institutions; nevertheless, credit conditions for households and firms remain extremely tight. The Committee anticipates that a gradual recovery in economic activity will begin later this year, but the downside risks to that outlook are significant.

In light of the declines in the prices of energy and other commodities in recent months and the prospects for considerable economic slack, the Committee expects that inflation pressures will remain subdued in coming quarters. Moreover, the Committee sees some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.

The Federal Reserve will employ all available tools to promote the resumption of sustainable economic growth and to preserve price stability. The focus of the Committee's policy is to support the functioning of financial markets and stimulate the economy through open market operations and other measures that are likely to keep the size of the Federal Reserve's balance sheet at a high level. The Federal Reserve continues to purchase large quantities of agency debt and mortgage-backed securities to provide support to the mortgage and housing markets, and it stands ready to expand the quantity of such purchases and the duration of the purchase program as conditions warrant. The Committee also is prepared to purchase longer-term Treasury securities if evolving circumstances indicate that such transactions would be particularly effective in improving conditions in private credit markets. The Federal Reserve will be implementing the Term Asset-Backed Securities Loan Facility to facilitate the extension of credit to households and small businesses. The Committee will continue to monitor carefully the size and composition of the Federal Reserve's balance sheet in light of evolving financial market developments and to assess whether expansions of or modifications to lending facilities would serve to further support credit markets and economic activity and help to preserve price stability."

Voting for this action: Messrs. Bernanke and Dudley, Ms. Duke, Messrs. Evans, Kohn, Lockhart, and Warsh, and Ms. Yellen.

Voting against this action: Mr. Lacker.

Mr. Lacker dissented because he preferred to expand the monetary base by purchasing U.S. Treasury securities rather than through targeted credit programs. Mr. Lacker was fully supportive of the significant expansion of the Federal Reserve's balance sheet and the intention to maintain the size of the balance sheet at a high level. However, while he recognized that spreads were elevated and volumes low in many credit markets, he saw no evidence of market failures that made targeted credit programs, including the forthcoming TALF, necessary. Moreover, he was concerned that such programs channel credit away from other worthy borrowers, amount to fiscal policy, would exacerbate moral hazard, and might be hard to unwind. He supported, instead, maintaining the size of the balance sheet at a high level through purchases of U.S. Treasury securities. In his view, such purchases would limit distortions to private credit flows, minimize adverse incentive effects, and maintain a clear distinction between monetary and fiscal policies.

It was agreed that the next meeting of the Committee would be held on Tuesday, March 17, 2009. The meeting adjourned at 1:05 p.m. on January 28, 2009.

Notation Vote

By notation vote completed on January 5, 2009, the Committee unanimously approved the minutes of the FOMC meeting held on December 15–16, 2008.

Conference Call

On January 16, 2009, the Committee met by conference call to discuss issues associated with establishing an explicit numerical objective for inflation. The Committee made no decisions on whether to establish such an objective. Most meeting participants expressed the view that an explicit numerical objective for longer-run inflation would be fully consistent with the Federal Reserve's dual mandate of promoting maximum employment and price stability and would not impede fostering the stability of the financial system. A number of participants emphasized that additional clarity on the longer-run inflation goal would further enhance Federal Reserve communications but would not involve any substantive change in monetary policy strategy. Many participants agreed that establishing and maintaining a transparent numerical inflation objective would be helpful—at least to some degree—in anchoring inflation expectations and thereby improve the overall effectiveness of monetary policy; others judged that the potential benefits of an explicit numerical inflation objective might be largely attained by extending the horizon of their regular projections for economic activity and inflation. Some indicated that the establishment of a numerical inflation objective could be particularly helpful under present circumstances in forestalling an unwelcome decline in longer-run inflation expectations—and hence in contributing to economic recovery—while also assuring the public that actions taken to counter economic weakness will not lead to high inflation over the longer-run. However, several participants expressed concern that an initiative to clarify the Committee's longer-run inflation objective could be confusing to the public in the current context of economic weakness and financial market strains. Participants also discussed several technical issues related to the implementation and communication of an explicit numerical inflation objective. They expressed a range of views about whether such an objective should be expressed in terms of the consumer price index or the PCE price deflator, the merits of a point value versus a range, the length of time over which policy would aim to achieve any such objective, and the frequency with which the Committee would reevaluate this framework. At this meeting, the staff also briefed the Committee on the coordinated set of measures for supporting Bank of America that had been taken by the Treasury, the FDIC, and the Federal Reserve earlier that day.

Brian F. Madigan
Secretary

Addendum: Summary of Economic Projections

In conjunction with the January 27–28, 2009 FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in deliberations of the FOMC, provided projections for economic growth, unemployment, and inflation in 2009, 2010, 2011, and over the longer run. Projections were based on information available through the conclusion of the meeting, on each participant's assumptions regarding a range of factors likely to affect economic outcomes, and on his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future policy that, based on current information, is deemed most likely to foster outcomes for economic activity and inflation that best satisfy the participant's interpretation of the Federal Reserve's dual objectives of maximum employment and price stability. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

FOMC participants viewed the outlook for economic activity and inflation as having weakened significantly since last October, when their last projections were made. As indicated in Table 1 and depicted in Figure 1, participants projected that real GDP would contract this year, that the unemployment rate would increase substantially, and that consumer price inflation would be significantly lower than in recent years.

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, January 2009
Percent

Variable	Central tendency[1]				Range[2]			
	2009	2010	2011	Longer Run	2009	2010	2011	Longer Run
Change in real GDP	−1.3 to −0.5	2.5 to 3.3	3.8 to 5.0	2.5 to 2.7	−2.5 to 0.2	1.5 to 4.5	2.3 to 5.5	2.4 to 3.0
October projection	−0.2 to 1.1	2.3 to 3.2	2.8 to 3.6	n.a.	−1.0 to 1.8	1.5 to 4.5	2.0 to 5.0	n.a.
Unemployment rate	8.5 to 8.8	8.0 to 8.3	6.7 to 7.5	4.8 to 5.0	8.0 to 9.2	7.0 to 9.2	5.5 to 8.0	4.5 to 5.5
October projection	7.1 to 7.6	6.5 to 7.3	5.5 to 6.6	n.a.	6.6 to 8.0	5.5 to 8.0	4.9 to 7.3	n.a.
PCE inflation	0.3 to 1.0	1.0 to 1.5	0.9 to 1.7	1.7 to 2.0	−0.5 to 1.5	0.7 to 1.8	0.2 to 2.1	1.5 to 2.0
October projection	1.3 to 2.0	1.4 to 1.8	1.4 to 1.7	n.a.	1.0 to 2.2	1.1 to 1.9	0.8 to 1.8	n.a.
Core PCE inflation[3]	0.9 to 1.1	0.8 to 1.5	0.7 to 1.5		0.6 to 1.5	0.4 to 1.7	0.0 to 1.8	
October projection	1.5 to 2.0	1.3 to 1.8	1.3 to 1.7		1.3 to 2.1	1.1 to 1.9	0.8 to 1.8	

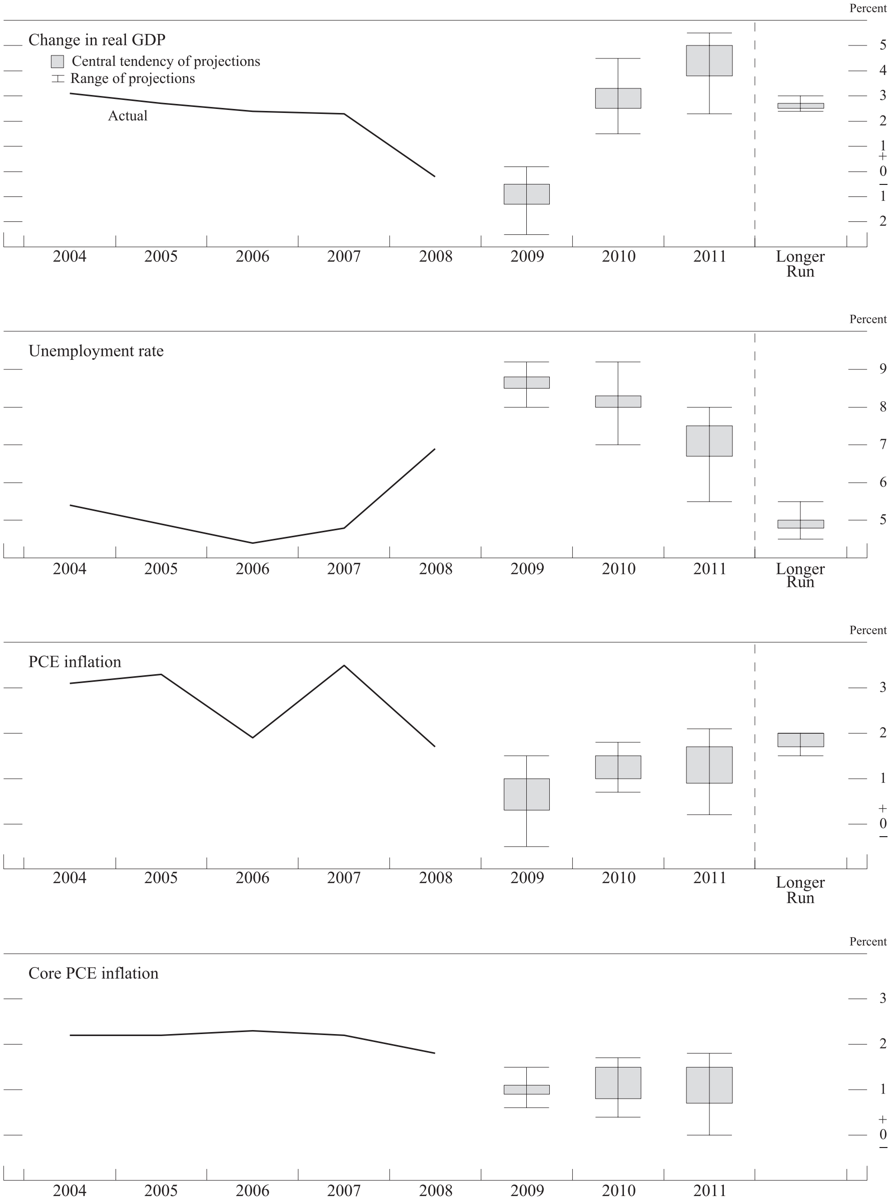
NOTE: Projections of change in real gross domestic product (GDP) and of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The October projections were made in conjunction with the FOMC meeting on October 28–29, 2008.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.

2. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.

3. Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2009–11 and over the longer run



NOTE: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual.

Given the strength of the forces currently weighing on the economy, participants generally expected that the recovery would be unusually gradual and prolonged: All participants anticipated that unemployment would remain substantially above its longer-run sustainable rate at the end of 2011, even absent further economic shocks; a few indicated that more than five to six years would be needed for the economy to converge to a longer-run path characterized by sustainable rates of output growth and unemployment and by an appropriate rate of inflation. Participants generally judged that their projections for both economic activity and inflation were subject to a degree of uncertainty exceeding historical norms. Nearly all participants viewed the risks to the growth outlook as skewed to the downside, and all participants saw the risks to the inflation outlook as either balanced or tilted to the downside.

The Outlook

Participants' projections for the change in real GDP in 2009 had a central tendency of –1.3 to –0.5 percent, compared with the central tendency of –0.2 to 1.1 percent for their projections last October. In explaining these downward revisions, participants referred to the further intensification of the financial crisis and its effect on credit and wealth, the waning of consumer and business confidence, the marked deceleration in global economic activity, and the weakness of incoming data on spending and employment. Participants anticipated a broad-based decline in aggregate output during the first half of this year; they noted that consumer spending would likely be damped by the deterioration in labor markets, the tightness of credit conditions, the continuing decline in house prices, and the recent sharp reduction in stock market wealth, and they saw reductions in consumer demand contributing to further weakness in business investment. However, participants expected that the economy would begin to recover—albeit gradually—during the second half of the year, mainly reflecting the effects of fiscal stimulus and of Federal Reserve measures providing support to credit markets.

Looking further ahead, participants' growth projections had a central tendency of 2.5 to 3.3 percent for 2010 and 3.8 to 5.0 percent for 2011. Participants generally expected that strains in financial markets would ebb only slowly and hence that the pace of recovery in 2010 would be damped. Nonetheless, participants generally anticipated that real GDP growth would gain further momentum in 2011, reaching a pace that would temporarily exceed their estimates of the longer-run sustainable rate of economic growth and would thereby help reduce the slack in resource utilization. Most participants expected that, absent further shocks, economic growth would eventually converge to a rate of 2.5 to 2.7 percent, reflecting longer-term trends in the growth of productivity and the labor force.

Participants anticipated that labor market conditions would deteriorate substantially further over the course of this year, and nearly all expected that unemployment would still be well above its longer-run sustainable rate at the end of 2011. Participants' projections for the average unemployment rate during the fourth quarter of 2009 had a central tendency of 8.5 to 8.8 percent, markedly higher than last December's actual unemployment rate of 7.2 percent the latest available figure at the time of the January FOMC meeting. Nearly all participants' projections were more than a percentage point higher than their previous forecasts made last October, reflecting the sharp rise in actual unemployment that occurred during the final months of 2008 as well as participants' weaker outlook for economic activity this year. Most participants anticipated that output growth in 2010 would not be substantially above its longer-run trend rate and hence that unemployment would decline only modestly next year. With economic activity and job creation generally projected to accelerate in 2011, participants anticipated that joblessness would decline more appreciably that year, as is evident from the central tendency of 6.7 to 7.5 percent for their unemployment rate projections. Participants expected that the unemployment rate would decline further after 2011, and most saw it settling in at a rate of 4.8 to 5.0 percent over time.

The central tendency of participants' projections for total PCE inflation this year was 0.3 to 1.0 percent, about a percentage point lower than the central tendency of their projections last October. Many participants noted that recent readings on inflation had been surprisingly low, and some anticipated that the unexpected declines in the prices of energy and other commodities that had occurred in the latter part of 2008 would continue to hold down inflation at the consumer level in 2009. Participants also marked down their projections for core PCE inflation this year in light of their views about the indirect effects of lower energy prices and the influence of increased resource slack.

Looking beyond this year, participants' projections for total PCE inflation had a central tendency of 1.0 to 1.5 percent for 2010, 0.9 to 1.7 percent for 2011, and 1.7 to 2.0 percent over the longer run. Participants' longer-run projections for total PCE inflation reflected their individual assessments of the measured rates of inflation consistent with the Federal Reserve's dual mandate for promoting price stability and maximum employment. Most participants judged that a longer-run PCE inflation rate of 2 percent would be consistent with the dual mandate; others indicated that 1½ or 1¾ percent inflation would be appropriate. Modestly positive longer-run inflation would allow the Committee to stimulate economic activity and support employment by setting the federal funds rate temporarily below the inflation rate when the economy is buffeted by a large negative shock to demands for goods and services. Participants generally expected that core and overall inflation would converge over time, and that persistent economic slack would continue to weigh on inflation outcomes for the next few years and hence that total PCE inflation in 2011 would still be below their assessments of the appropriate inflation rate for the longer run.

Risks to the Outlook

Participants continued to view uncertainty about the outlook for economic activity as higher than normal.[5] The risks to their projections for real GDP growth were judged as being skewed to the downside and the associated risks to their projections for the unemployment rate were tilted to the upside. Par-

5. Table 2 provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1987 to 2007. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risks attending participants' projections.

Table 2. Average historical projection error ranges

Percentage points

Variable	2009	2010	2011
Change in real GDP[1] . . .	±1.2	±1.4	±1.4
Unemployment rate[1]	±0.5	±0.8	±1.0
Total consumer prices[2] . .	±0.9	±1.0	±0.9

NOTE: Error ranges shown are measured as plus or minus the root mean squared error of projections that were released in the winter from 1987 through 2007 for the current and following two years by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Board of Governors of the Federal Reserve System, November).

1. For definitions, refer to general note in table 1.

2. Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated. The slightly narrower estimated width of the confidence interval for inflation in the third year compared with that for the second year is likely the result of using a limited sample period for computing these statistics.

ticipants highlighted the considerable degree of uncertainty about the future course of the financial crisis and its impact on the real economy; for example, rising unemployment and weaker growth could exacerbate delinquencies on household and business loans, leading to higher losses for financial firms and so to a further tightening of credit conditions that would in turn put further downward pressure on spending to a greater degree than currently foreseen. In addition, some participants noted that a substantial degree of uncertainty was associated with gauging the stimulative effects of nontraditional monetary policy tools that are now being employed given that conventional policy easing was limited by the zero lower bound on nominal interest rates. Others referred to uncertainties regarding the size, composition, and effectiveness of the fiscal stimulus package—which was still under consideration at the time of the FOMC meeting—and of further measures to stabilize the banking system.

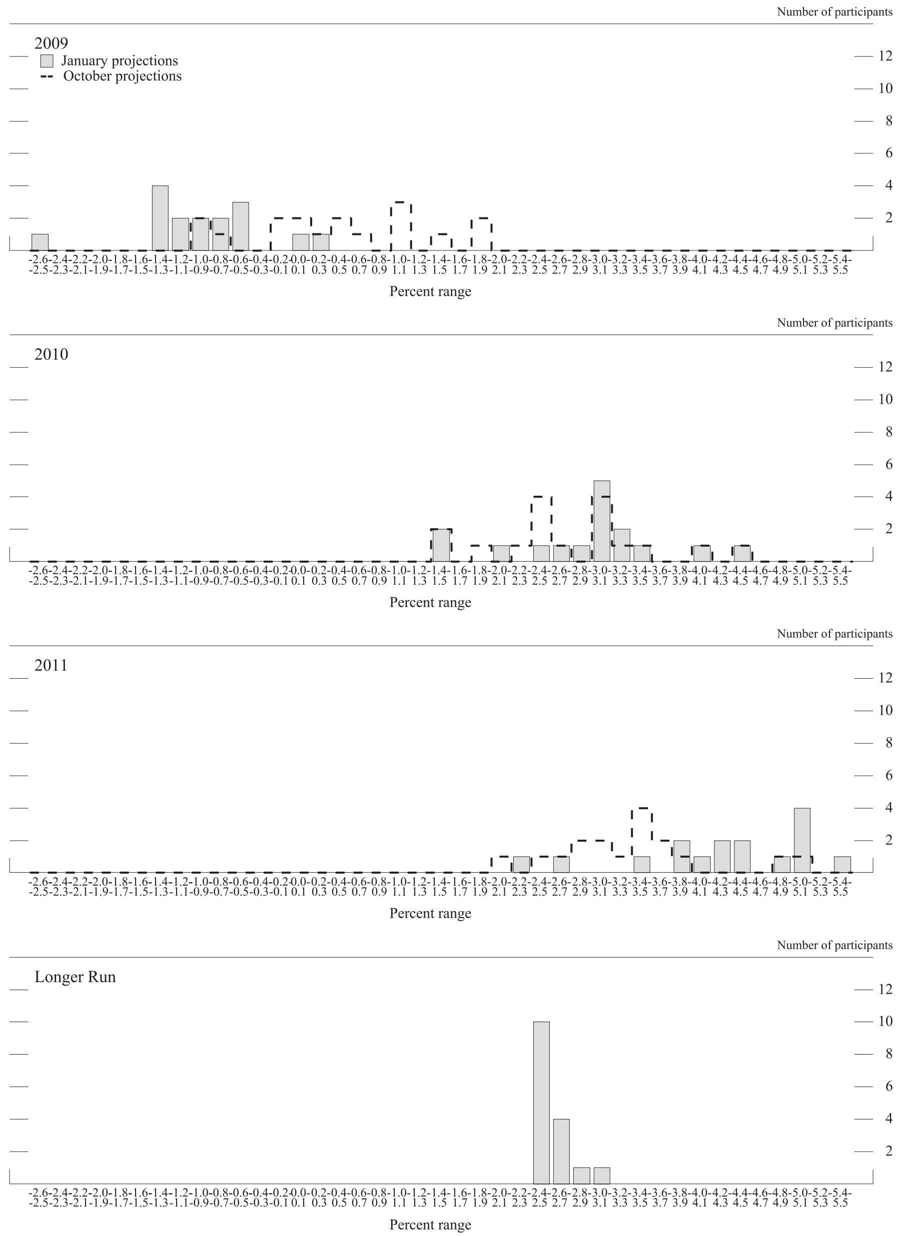
As in October, most participants continued to view the uncertainty surrounding their inflation projections as higher than historical norms. A slight majority of participants judged the risks to the inflation outlook as roughly balanced, while the rest viewed these risks as skewed to the downside. Participants indicated that elevated uncertainty about global growth was clouding the outlook for prices of energy and other commodities and hence contributing to greater uncertainty in their inflation projections. Many participants stated that their assessments regarding the level of uncertainty and balance of risks to the inflation outlook were closely linked to their judgments about the uncertainty and risks to the outlook for economic activity. Some participants noted the risk that inflation expectations might become unanchored and drift downward in response to persistently low inflation outcomes, while others pointed to the possibility of an upward shift if investors became concerned that stimulative policy measures might not be unwound in a timely fashion once the economy begins to recover.

Diversity of Views

Figures 2.A and 2.B provide further details on the diversity of participants' views regarding likely outcomes for real GDP growth and the unemployment rate, respectively. For 2009 to 2011, the dispersion in participants' projections for each variable was roughly the same as for their projections last October. This dispersion mainly indicated the diversity of participants' assessments regarding the stimulative effects of fiscal policy, the pace of recovery in financial markets, and the evolution of households' desired saving rates. The dispersion in participants' longer-run projections reflected differences in their estimates regarding the sustainable rates of output growth and unemployment to which the economy would converge under appropriate policy and in the absence of any further shocks.

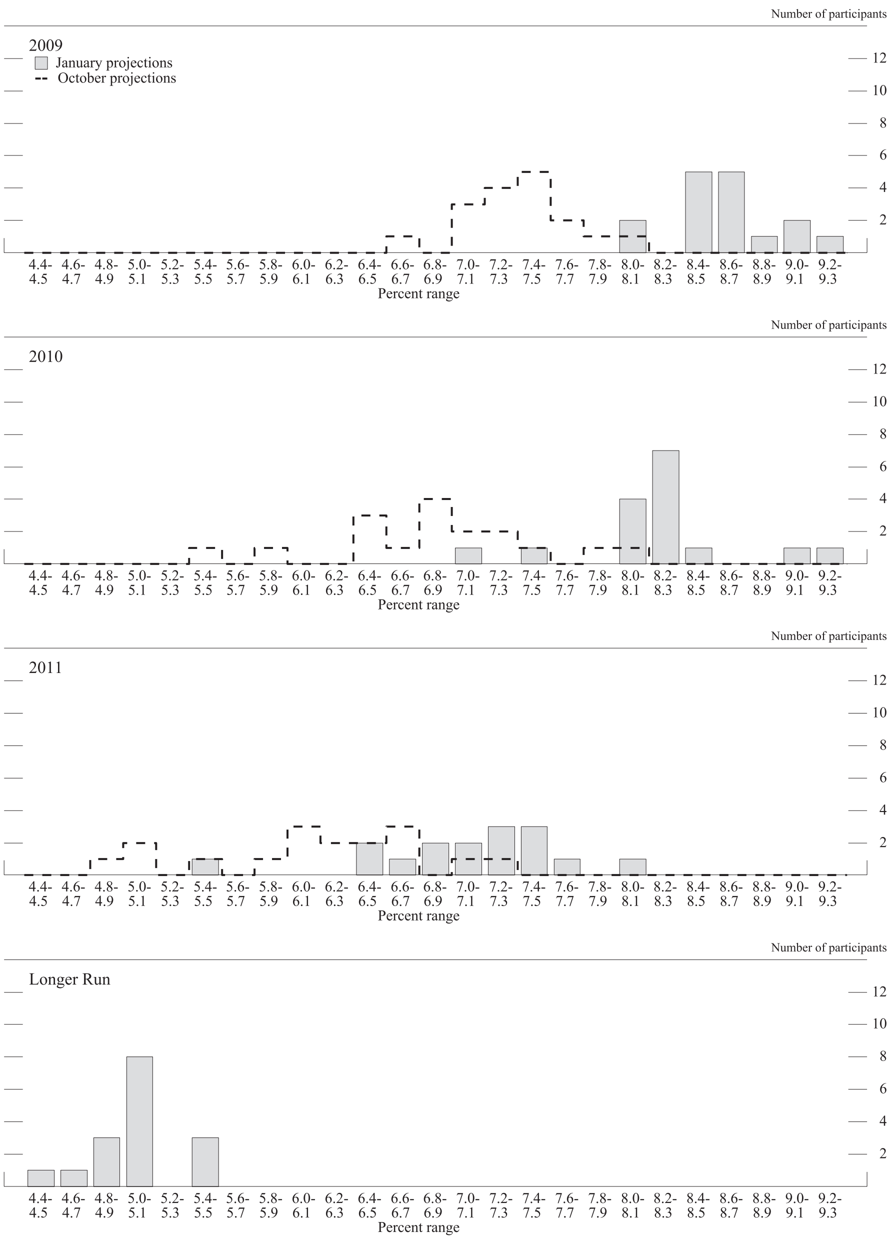
Figures 2.C and 2.D provide corresponding information regarding the diversity of participants' views regarding the inflation outlook. The dispersion in participants' projections for total PCE inflation in 2009 was substantially greater than for their projections made last October, due to increased diversity of participants' views regarding the near-term evolution of prices of energy and raw materials and the extent to which changes in those prices would be likely to pass through into overall inflation. The dispersion in participants' projections for core PCE inflation in 2009 was noticeably lower than last October, but the dispersion in their projections for core inflation in 2010 and 2011 was markedly wider, reflecting varying assessments about the timing and pace of economic recovery, the sensitivity of inflation to slack in resource utilization, the prevalence of downward nominal wage rigidity, and the likelihood that inflation expectations will remain firmly anchored. A few participants anticipated that inflation in 2011 would be close to their longer-run projections. However, most participants' projections for total PCE inflation in 2011 were below their longer-run projections, primarily reflecting the anticipated effects of substantial slack over the next three years; this inflation gap was about ¼ to ½ percentage point for some participants but exceeded a full percentage point for others.

Figure 2.A. Distribution of participants' projections for the change in real GDP, 2009–11 and over the longer run



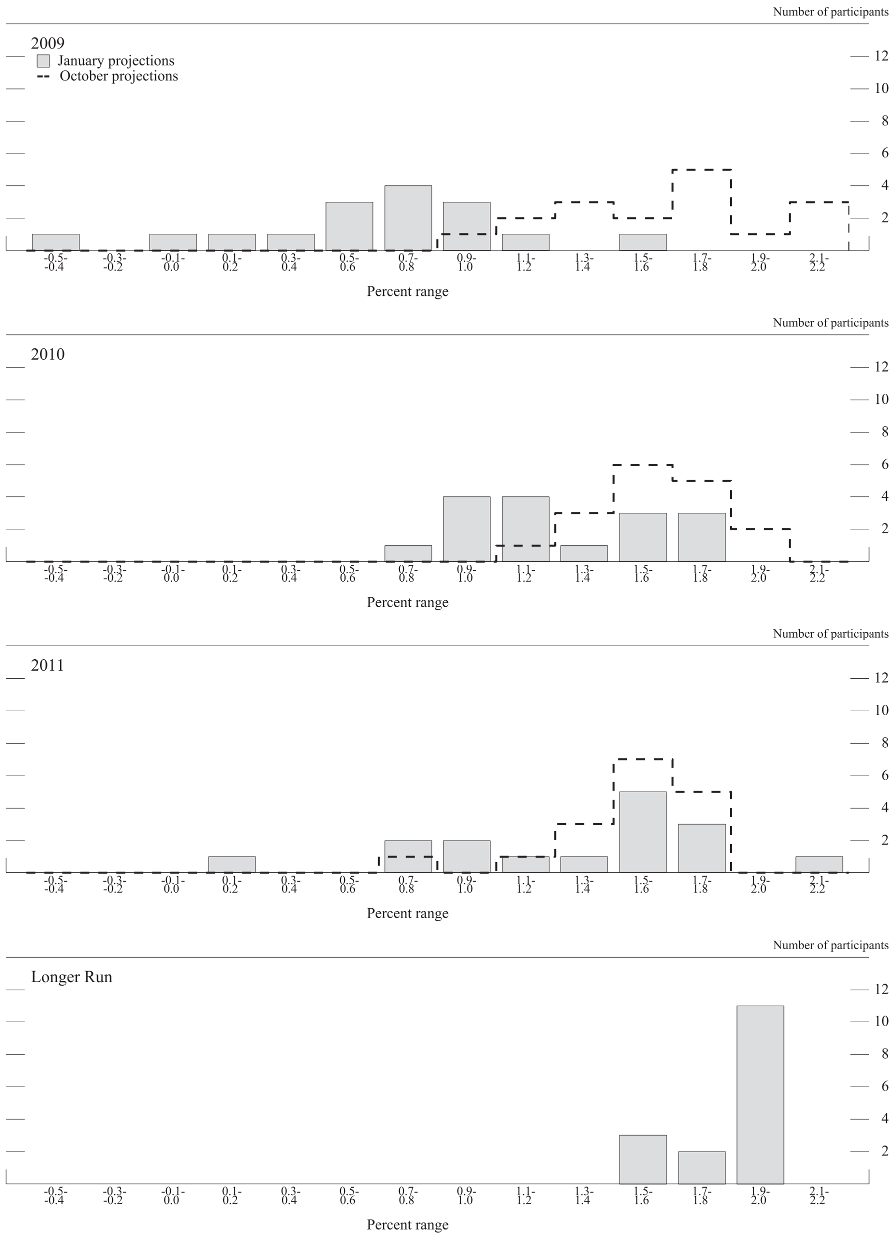
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of participants' projections for the unemployment rate, 2009–11 and over the longer run



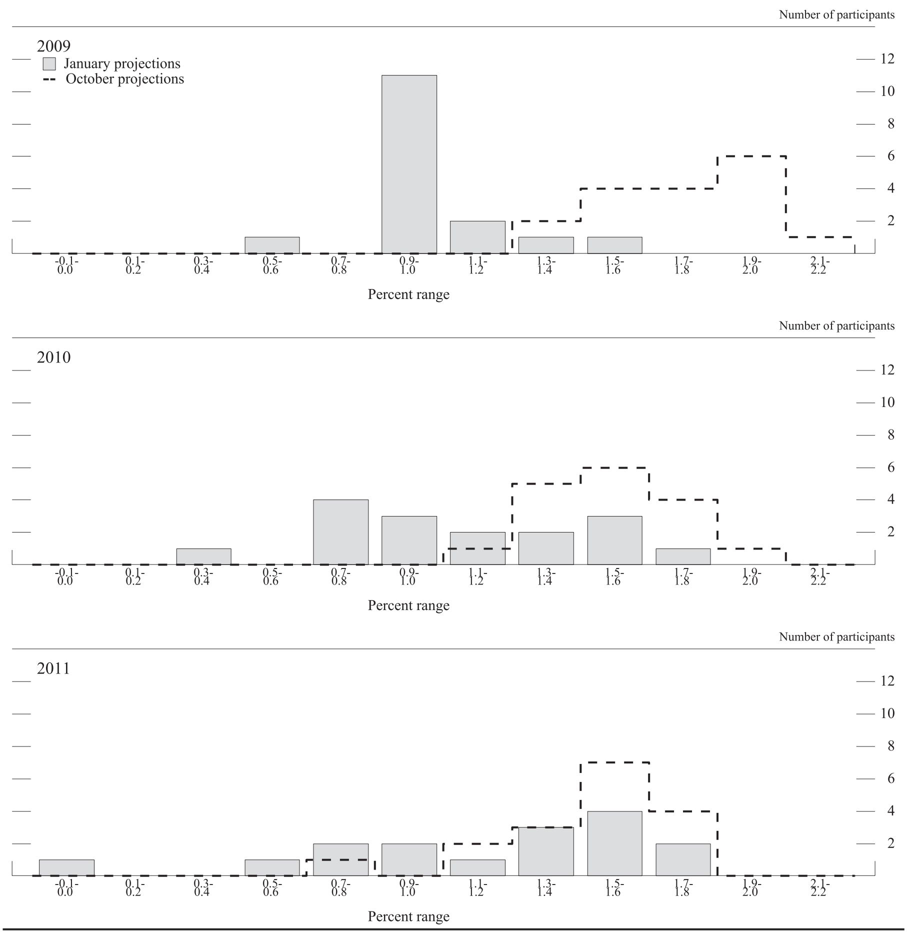
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of participants' projections for PCE inflation, 2009–11 and over the longer run



NOTE: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of participants' projections for core PCE inflation, 2009–11



NOTE: Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past Monetary Policy Reports and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real GDP and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand between 1.8 percent to 4.2 percent in the current year and 1.6 percent to 4.4 percent in the second and third years. The corresponding 70 percent confidence intervals for overall inflation would be 1.1 percent to 2.9 percent in the current year, 1.0 percent to 3.0 percent in the second year, and 1.1 percent to 2.9 percent in the third year.

Because current conditions may differ from those that prevailed on average over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection, rather than with divergences across a number of different projections.

Meeting Held on March 17–18, 2009

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Tuesday, March 17, 2009, at 2:00 p.m. and continued on Wednesday, March 18, 2009, at 9:00 a.m.

Present:

Mr. Bernanke, Chairman
Mr. Dudley, Vice Chairman
Ms. Duke
Mr. Evans
Mr. Kohn
Mr. Lacker
Mr. Lockhart
Mr. Tarullo
Mr. Warsh
Ms. Yellen

Mr. Bullard, Ms. Cumming, Mr. Hoenig, Ms. Pianalto, and Mr. Rosengren, Alternate Members of the Federal Open Market Committee

Messrs. Fisher, Plosser, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis, respectively

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Mr. Luecke, Assistant Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Sheets, Economist
Mr. Stockton, Economist

Messrs. Altig, Clouse, Connors, Kamin, Slifman, Sullivan, Weinberg, Wilcox, and Williams, Associate Economists

Ms. Mosser, Temporary Manager, System Open Market Account

Ms. Johnson, Secretary of the Board, Office of the Secretary, Board of Governors

Mr. Frierson, Deputy Secretary, Office of the Secretary, Board of Governors

Mr. Struckmeyer, Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

Ms. Bailey and Mr. English, Deputy Directors, Divisions of Banking Supervision and Regulation and Monetary Affairs, respectively, Board of Governors

Mr. Blanchard, Assistant to the Board, Office of Board Members, Board of Governors

Messrs. Leahy, Nelson, Reifschneider, and Wascher,[6] Associate Directors, Divisions of International Finance, Monetary Affairs, Research and Statistics, and Research and Statistics, respectively, Board of Governors

Mr. Gagnon, Visiting Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Oliner, Senior Adviser, Division of Research and Statistics, Board of Governors

Mr. Lewis, Economist, Division of Monetary Affairs, Board of Governors

Ms. Beattie,[6] Assistant to the Secretary, Office of the Secretary, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Mr. Williams, Records Management Analyst, Division of Monetary Affairs, Board of Governors

Mr. Sapenaro, First Vice President, Federal Reserve Bank of St. Louis

Messrs. Fuhrer and Rosenblum, Executive Vice Presidents, Federal Reserve Banks of Boston and Dallas, respectively

6. Attended Tuesday's session only.

Messrs. Hilton and Schweitzer, Senior Vice Presidents, Federal Reserve Banks of New York and Cleveland, respectively

Messrs. Clark, Gavin, Klitgaard, and Yi, Vice Presidents, Federal Reserve Banks of Kansas City, St. Louis, New York, and Philadelphia, respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on recent developments in domestic and foreign financial markets. The Manager also reported on System open market operations in Treasury securities and in agency debt and agency mortgage-backed securities (MBS) during the period since the Committee's January 27–28 meeting. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account during the period since the Committee's January 27–28 meeting.

Staff reported on recent developments in System liquidity programs and on changes in the System's balance sheet. As of March 12, the System's total assets and liabilities were about $2 trillion, close to the level of that just before the January 27–28 meeting. Holdings of agency debt and agency MBS had increased, while foreign central bank drawings on reciprocal currency arrangements had declined. Credit extended by the Commercial Paper Funding Facility also had declined, as 90-day paper purchased in the early weeks of the program matured and a large portion was not renewed through the facility. Primary credit extended by the Federal Reserve was about unchanged, and credit outstanding under the Term Auction Facility increased somewhat over the period as the February auctions experienced higher demand than previous auctions. In contrast, credit extended under the Primary Dealer Credit Facility declined somewhat over the intermeeting period, and credit extended under the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility edged down.

Most meeting participants interpreted the evidence as indicating that credit markets still were not working well, and that the Federal Reserve's lending programs, asset purchases, and currency swaps were providing much-needed support to economic activity by reducing dislocations in financial markets, lowering the cost of credit, and facilitating the flow of credit to businesses and households. Participants discussed the prospective further increase in the Federal Reserve's balance sheet, with a focus on the Term Asset-Backed Securities Loan Facility (TALF) and open market purchases of longer-term assets.

The launch of the TALF was announced on March 3. In the initial phase of the program, the Federal Reserve offered to provide up to $200 billion of three-year loans, on a nonrecourse basis, against AAA-rated asset-backed securities (ABS) backed by newly and recently originated auto loans, credit card loans, student loans, loans guaranteed by the Small Business Administration, and, potentially, certain other closely related types of ABS. The Federal Reserve and the Treasury had previously announced their expectation that the program would be expanded to accept other types of ABS. The demand for TALF funding appeared likely to be modest initially, and some participants saw a risk that private firms might be reluctant to borrow from the TALF out of concern about potential future changes in government policies that could affect TALF borrowers. However, other participants anticipated that TALF loans would increase over time as financial market institutions became more familiar with the program. Most participants supported the expansion of the lending capacity of the TALF, subject to receiving additional capital from the Treasury, and the inclusion of additional categories of recently issued, highly rated ABS as acceptable collateral. However, some participants expressed concern about the risks that might arise from the possible extension of the TALF to include older and lower-quality assets, noting, in particular, the greater uncertainty over the value of such assets.

The Federal Reserve's programs to buy direct debt obligations of the federal housing agencies and agency-guaranteed MBS were on track to reach their initial targets of $100 billion and $500 billion, respectively, by the end of June. Participants agreed that the asset purchase programs were helping to reduce mortgage interest rates and improve market functioning, thereby providing support to economic activity. Some participants stated a preference for communicating the Committee's intention regarding such purchases in terms of the growth rate of Federal Reserve holdings rather than a dollar target for total purchases. However, others noted that the pace of MBS issuance was likely to be especially brisk over the next few months, in part because of the Administration's new Making Home Affordable program, and observed that it could be advantageous to be able to front-load purchases to accommodate the pattern of mortgage refinancing. Participants also discussed the relative merits of increasing the Federal Reserve's purchases of agency MBS versus initiating purchases of longer-term Treasury securities. Some participants remarked that experience suggested that purchases of Treasury securities would have effects across a variety of long-term debt markets and should ease financial conditions generally while minimizing the Federal Reserve's influence on the allocation of credit. However, purchases of agency securities could have a more direct effect on mortgage rates, thus providing greater benefits to the housing sector, and on private borrowing rates more generally. Also, some participants were concerned that Federal Reserve purchases of longer-term Treasury securities might be seen as an indication that the Federal Reserve was responding to a fiscal objective rather than its statutory mandate, thus reducing the Federal Reserve's credibility regarding long-run price stability. Most participants, however, saw this risk as low so long as the Federal Reserve was clear about the importance of its long-term price stability objective and demonstrated a commitment to take the necessary steps in the future to achieve its objectives.

In light of the economic and financial conditions, meeting participants viewed the expansion of the Federal Reserve's balance sheet that might be associated with these and other programs as appropriate in order to foster the dual objectives of maximum employment and price stability. It was noted that the Treasury and the Federal Reserve will seek legislation to give the Federal Reserve tools in addition to interest on reserves to manage the federal funds rate while providing the funding necessary for the TALF and other key credit-easing programs.

The Committee also took up a proposal to augment the existing network of central bank liquidity swap lines by adding several temporary swap lines that could provide foreign currency liquidity to U.S. institutions, analogous to the arrangements that currently provide U.S. dollar liquidity abroad. There was no evidence that these institutions were encountering difficulty in meeting foreign currency obligations at this time, but these facilities would be available should pressures develop in the future. The Committee unanimously approved the following resolution:

> "The Federal Open Market Committee authorizes the Federal Reserve Bank of New York to enter into additional temporary reciprocal currency arrangements (swap lines) with the Bank of England, the European Central Bank (ECB), the Bank of Japan, and the Swiss National Bank to support the provision of liquidity in British pounds, euros, Japanese yen, and Swiss francs. The swap arrangements with each foreign central bank shall be subject to the following limits: an aggregate amount of up to £30 billion with the Bank of England; an aggregate amount of up to €80 billion with the ECB; an aggregate amount of up to ¥10 trillion with the Bank of Japan; and an aggregate amount of up to SwF 40 billion with the Swiss National Bank. These arrangements shall terminate no later than October 30, 2009, unless extended by mutual agreement of the Committee and the respective foreign central banks. The Committee also authorizes the Federal Reserve Bank of New York to provide the foreign currencies obtained under the arrangements to U.S. financial institutions by means of swap transactions to assist such institutions in meeting short-term liquidity needs in their foreign operations. Requests for drawings on the central bank swap lines and distribution of the foreign currency proceeds to U.S. financial institutions shall be initiated by the appropriate Reserve Bank and approved by the Foreign Currency Subcommittee."

Staff Review of the Economic and Financial Situation

The information reviewed at the March 17–18 meeting indicated that economic activity had fallen sharply in recent months. The contraction was reflected in widespread declines in payroll employment and industrial production. Consumer spending appeared to remain at a low level after changing little, on balance, in recent months. The housing market weakened further, and nonresidential construction fell. Business spending on equipment and software continued to fall across a broad range of categories. Despite the cutbacks in production, inventory overhangs appeared to worsen in a number of areas. Both headline and core consumer prices edged up in January and February.

Labor market conditions continued to deteriorate. Private payroll employment dropped considerably over the three months ending in February. Employment losses remained widespread across industries, with the notable exception of health care. Meanwhile, the average workweek of production and nonsupervisory workers on private payrolls continued to be low in February, and the number of aggregate hours worked for this group was markedly below the fourth-quarter average. The civilian unemployment rate climbed ½ percentage point in February, to 8.1 percent. The labor force participation rate declined in January and February, on balance, likely in response to weakened labor demand. The four-week moving average of initial claims for unemployment insurance continued to move up through early March, and the level of insured unemployed rose further.

Industrial production fell in January and February, with cutbacks again widespread, and capacity utilization in manufacturing declined to a very low level. Although production of light motor vehicles turned up in February, it remained well below the pace of the fourth quarter as manufacturers responded to the significant deterioration in demand over the past few months. The output of high-tech products declined as production of computers and semiconductors extended the sharp declines that began in the fourth quarter of 2008. The production of other consumer durables and business equipment weakened further, and broad indicators of near-term manufacturing activity suggested that factory output would continue to contract over the next few months.

The available data suggested that real consumer spending held steady, on balance, in the first two months of this year after having fallen sharply over the second half of last year. Real spending on goods excluding motor vehicles was estimated to have edged up, on balance, in January and February. In contrast, real outlays on motor vehicles contracted further in February after a decline in January. The financial strain on households intensified over the previous several months; by the end of the fourth quarter, household net worth for the first time since 1995 had fallen to less than five times disposable income, and substantial declines in equity and house prices continued early this year. Consumer sentiment declined further in February as households voiced greater concerns about income and job prospects. The Reuters/University of Michigan index in early March stood only slightly above its 29-year low reached in November, and the Conference Board index, which includes questions about employment conditions, fell in February to a new low.

Housing activity continued to be subdued. Single-family starts ticked up in February, and adjusted permit issuance in this sector moved up to a level slightly above starts. Multifamily starts jumped in February from the very low level in January, and the level of multifamily starts was close to where it had been at the end of the third quarter of 2008. Housing demand remained very weak, however. Although the stock of unsold new single-family homes fell in January to its lowest level since 2003, inventories continued to move up relative to the slow pace of sales. Sales of existing single-family homes fell in January, reversing the uptick seen in December. Over the previous 12 months, the pace of existing home sales declined much less than that of new home sales, reflecting in part increases in foreclosure-related and other distressed sales. The weakness in home sales persisted despite historically low mortgage rates for borrowers eligible for conforming loans. After having fallen significantly late last year, rates for conforming 30-year fixed-rate mortgages fluctuated in a relatively narrow range during the intermeeting period. In contrast, the market for nonconforming loans remained severely impaired. House prices continued to decline.

Business spending on transportation equipment continued to fall from already low levels, and demand both for high-tech equipment and software and for equipment other than high-tech and transportation dropped sharply in the fourth quarter. In January, nominal shipments of nondefense capital goods excluding aircraft declined, and new orders fell significantly further. The fundamental determinants of equipment and software spending worsened appreciably: Business output dropped, and rising corporate bond yields boosted the user cost of capital in the fourth quarter. After holding up surprisingly well through most of last year, outlays on nonresidential structures began to show declines consistent with the weak fundamentals for this sector. In real terms, investment declined for most types of buildings over the previous few months. Census data on book-value inventory investment for January suggested that firms had further pared their stocks; however, sales continued to fall more quickly than inventories, apparently exacerbating the overhangs that developed in the second half of 2008.

The U.S. international trade deficit narrowed in December and January, as a steep fall in imports more than offset a decline in exports. All major categories of exports decreased, especially sales of industrial supplies, machinery, and automotive products. All major categories of imports decreased as well, with large declines in imports of oil, automotive products, and industrial supplies. The drop in the value of oil imports reflected a lower price. Imports of automotive products declined as automakers made significant production cutbacks throughout North America.

Output in the advanced foreign economies contracted in the fourth quarter, with large reductions in real gross domestic product (GDP) in all the major economies and a double-digit rate of decline in Japan. Trade and investment in those countries were particularly weak. Indicators of economic activity, especially industrial production, suggested that the pace of contraction accelerated late in the fourth quarter and into the first quarter. Economic activity in emerging market economies also weakened significantly in the fourth quarter. Exports, industrial production, and confidence indicators dropped notably in both Latin America and emerging Asia. Incoming data for January and February suggested a further significant decline in the first quarter.

In the United States, overall consumer prices increased in January and February, led by an increase in energy prices, after posting sizable declines late last year. Excluding the categories of food and energy, consumer prices edged higher in January and February after three months of no change. The producer price index for core intermediate materials dropped for a fifth month in February, reflecting, in part, weaker global demand and steep declines in the prices of a wide variety of energy-intensive goods, such as chemicals and plastics. Low readings on overall and core consumer price inflation in recent months, as well as the weakened economic outlook, kept near-term inflation expectations reported in surveys well below their high levels in mid-2008. In contrast, measures of longer-term expectations remained close to their averages over the past couple of years. Hourly earnings continued to increase at a moderate rate in February.

The Federal Open Market Committee's decision at the January meeting to leave the target range for the federal funds rate unchanged was widely anticipated by investors and had little impact on short-term money markets. Over the intermeeting period, the path for the federal funds rate implied by futures rates shifted down somewhat, on net, mostly on incoming news about the financial sector and the economic outlook. Yields on nominal Treasury coupon securities increased over the period, reportedly because market participants had assigned some probability to the possibility that the Federal Reserve would establish a purchase program for longer-term Treasury securities that was not, in fact, forthcoming; yields were also reported to have responded to concerns over the federal deficit and the growing supply of Treasury securities. Yields on longer-term inflation-indexed Treasury securities increased more than those on their nominal counterparts, leaving longer-term inflation compensation lower over the period, and inflation compensation at shorter horizons was little changed. Poor liquidity in the market for Treasury inflation-protected securities continued to make these readings difficult to interpret.

Conditions in short-term funding markets were mixed over the intermeeting period. In unsecured interbank funding markets, spreads of dollar London interbank offered rates (Libor) over comparable-maturity overnight index swap rates trended higher, on net, especially at longer maturities, and forward spreads increased, evidently on renewed concerns about the financial condition of some large banks. Conditions in the commercial paper (CP) market continued to improve, on balance, over the intermeeting period. Spreads on 30-day A2/P2-rated CP trended down further, and those on AA-rated asset-backed commercial paper remained at the lower end of the range recorded over the past year. Conditions in repurchase agreement markets for most collateral types improved over the period, but volumes remained low.

Trading conditions in the secondary market for nominal Treasury coupon securities showed some limited signs of improvement. Average bid-asked spreads for on-the-run nominal Treasury notes were relatively stable near their pre-crisis levels. Daily trading volumes for on-the-run securities, however, inched lower, and spreads between the yields of on- and off-the-run 10-year Treasury notes remained very high.

Broad equity price indexes dropped significantly, on balance, over the intermeeting period amid continued concerns about the health of the financial sector, uncertainty regarding the efficacy of government support to the sector, and a further weakening of the economic outlook. Bank stock prices were particularly hard hit, and the credit default swap (CDS) spreads of many banks rose above the peaks recorded last fall on anxieties about the financial conditions of the largest banking firms. Stock prices of insurance companies dropped sharply over the period, reflecting concerns about the adequacy of their capital positions. On March 2, American International Group, Inc. (AIG), reported losses of more than $60 billion for the fourth quarter of last year, and the Treasury and the Federal Reserve announced a restructuring of the government assistance to AIG to enhance the company's capital and liquidity to facilitate the orderly completion of its global divestiture program.

Measures of liquidity in the secondary market for speculative-grade corporate bonds worsened somewhat over the period but remained significantly better than in the fall of 2008. Spreads of yields on both BBB-rated and speculative-grade bonds relative to those on comparable-maturity Treasury securities were little changed on net. The investment- and speculative-grade CDS indexes widened significantly, on net, over the intermeeting period. Gross bond issuance by nonfinancial firms was very strong in January and February, as investment-grade issuance more than doubled from its already solid pace in the fourth quarter; speculative-grade issuance, however, remained sluggish. Trading conditions in the leveraged syndicated loan market improved slightly, but issuance continued to be very weak. The market for commercial mortgage-backed securities (CMBS) also remained under heavy stress. Indexes of CDS spreads on AAA-rated CMBS widened to record levels, as Moody's downgraded a large portion of the 2006 and 2007 vintages after a reevaluation of its rating criteria.

The debt of the domestic private nonfinancial sector, which was about unchanged in the fourth quarter of last year, was estimated to have remained about flat in the first quarter. Household debt appeared to have contracted in the first quarter for the second quarter in a row, primarily as a result of declines in both consumer and home mortgage debt. Declines in consumer and mortgage debt stemmed, in turn, from very weak household spending, the continued drop in house prices, and tighter terms and standards for loans. Business debt was projected to expand at a moderate pace in the first quarter, largely because of a burst of corporate bond issuance. Reflecting heavy borrowing by the Treasury, total debt of the domestic nonfinancial sector was projected to have continued to expand in the first quarter, but at a pace below that recorded in the fourth quarter of last year.

The rise in M2 slowed in February from the rapid pace recorded over the previous few months. Liquid deposits, while decelerating, continued to expand briskly. Savings deposits increased while demand deposits decreased. Retail money funds fell in February, reflecting sizable outflows from Treasury-only funds, which generally provided low yields. Small time deposits also contracted, as the institutions that had been bidding aggressively for these retail funds stopped doing so. The expansion in currency remained robust.

Bank credit continued to decline in January and February, and commercial and industrial (C&I) loans decreased over these months. The February Survey of Terms of Business Lending indicated that C&I loan rate spreads over comparable-maturity market instruments rose modestly overall from the November survey. Commercial real estate loans outstanding also declined over the first part of 2009. In contrast, consumer loans on banks' books jumped over the first two months of the year because of sizable increases at a few banks that purchased loans from their affiliated finance companies. In addition, some banks brought consumer loans that had previously been securitized back onto their books. After 12 consecutive months of contraction, residential mortgage loans on banks' books increased in February, likely a result of the pickup in refinancing activity. In contrast, the rise in home equity loans slowed noticeably in January and February.

Among the advanced foreign economies, headline equity price indexes generally fell significantly over the period, with the sharpest drops in the banking sector. In particular, European bank shares fell steeply as earnings reports for the fourth quarter came in weaker than expected and fears about the exposure of many western European banks to emerging Europe increased. The major currencies index of the dollar rose, on net, over the intermeeting period; foremost among the contributors to the rise was a significant appreciation of the dollar against the yen. Financial conditions in emerging markets also worsened, with their exchange rates and equity prices generally falling and CDS premiums rising a bit on balance.

Several foreign governments and central banks took further steps to support their financial markets and economies. The Bank of England announced its intention to purchase substantial quantities of government and corporate bonds through its Asset Purchase Facility, after which yields on long-term British gilts fell significantly. In addition, the British government launched its Asset Protection Scheme, which insured assets placed in the scheme by the Royal Bank of Scotland and Lloyds Bank. The Bank of Japan stated that it would resume purchases of equities held on banks' balance sheets, announced plans to purchase corporate bonds, and began its previously announced purchases of commercial paper. The Swiss National Bank announced that it would purchase both domestic corporate debt and foreign currency to increase liquidity.

Staff Economic Outlook

In the forecast prepared for the meeting, the staff revised down its outlook for economic activity. The deterioration in labor market conditions was rapid in recent months, with steep job losses across nearly all sectors. Industrial production continued to contract rapidly as firms responded to the falloff in demand and the buildup of some inventory overhangs. The incoming data on business spending suggested that business investment in equipment and structures continued to decline. Single-family housing starts had fallen to a post–World War II low in January, and demand for new homes remained weak. Both exports and imports retreated significantly in the fourth quarter of last year and appeared headed for comparable declines this quarter. Consumer outlays showed some signs of stabilizing at a low level, with real outlays for goods outside of motor vehicles recording gains in January and February. Financial conditions overall were even less supportive of economic activity, with broad equity indexes down significantly amid continued concerns about the health of the financial sector, the dollar stronger, and long-term interest rates higher. The staff's projections for real GDP in the second half of 2009 and in 2010 were revised down, with real GDP expected to flatten out gradually over the second half of this year and then to expand slowly next year as the stresses in financial markets ease, the effects of fiscal stimulus take hold, inventory adjustments are worked through, and the correction in housing activity comes to an end. The weaker trajectory of real output resulted in the projected path of the unemployment rate rising more steeply into early next year before flattening out at a high level over the rest of the year. The staff forecast for overall and core personal consumption expenditures (PCE) inflation over the next two years was revised down slightly. Both core and overall PCE price inflation were expected to be damped by low rates of resource utilization, falling import prices, and easing cost pressures as a result of the sharp net declines in oil and other raw materials prices since last summer.

Meeting Participants' Views and Committee Policy Action

In the discussion of the economic situation and outlook, nearly all meeting participants said that conditions had deteriorated relative to their expectations at the time of the January meeting. The slowdown was widespread across sectors. Large declines in equity prices, a further drop in house prices, and mounting job losses threatened to further depress consumer spending, despite some firming in the recent retail sales data and forthcoming tax reductions. Business capital spending was weakening in an environment of uncertainty and low business confidence. Of particular note was the apparent sharp fall in foreign economic activity, which was having a negative effect on U.S. exports. Credit conditions remained very tight, and financial markets remained fragile and unsettled, with pressures on financial institutions generally intensifying this year. Overall, participants expressed concern about downside risks to an outlook for activity that was already weak. With regard to the outlook for inflation, all participants agreed that inflation pressures were likely to remain subdued, and several expressed the view that inflation was likely to persist below desirable levels.

District business contacts indicated that production and sales were declining steeply. Some industries that previously were less affected, such as agriculture and energy, had begun to suffer the effects of the slowdown. Businesses reported that bank financing was becoming more expensive and more difficult to obtain. Expenditures were being cut substantially for a wide range of capital equipment, and spending on nonresidential structures had recently turned down. Inventory liquidation was continuing, but inventory-sales ratios remained elevated as sales slowed. Against this backdrop, participants anticipated further employment cutbacks over coming months, though perhaps at a gradually diminishing rate.

Several participants said that the degree and pervasiveness of the decline in foreign economic activity was one of the most notable developments since the January meeting. In light of this development, it was widely agreed that exports were not likely to be a source of support for U.S. economic activity in the near term.

Participants did not interpret the uptick in housing starts in February as the beginning of a new trend, but some noted that there was only limited scope for housing activity to fall further. Nonetheless, large inventories of unsold homes relative to sales and the prospect of a continued high level of distressed sales would continue to hold down residential investment in the near term. Several participants noted the tentative signs of stabilization in consumer spending in January and February. However, others suggested that strains on household balance sheets from falling equity and house prices, reduced credit availability, and the fear of unemployment could well lead to further increases in the saving rate that would damp consumption growth in the near term.

Overall, most participants viewed downside risks as predominating in the near term, mainly owing to potential adverse feedback effects as reduced employment and production weighed on consumer spending and investment, and as the weakening economy boosted the prospective losses of financial institutions, leading to a further tightening of credit conditions.

Looking beyond the very near term, a number of market forces and policies now in place were seen as eventually leading to economic recovery. Notably, the low level of mortgage interest rates, reduced house prices, and the Administration's new programs to encourage mortgage refinancing and mitigate foreclosures ultimately could bring about a lower cost of homeownership, a sustained increase in home sales, and a stabilization of house prices. The household saving rate, which had already risen considerably, would eventually level out and cease to hold back consumption growth. Business inventories would come into line with even a low level of sales, and the pressure on production from inventory drawdowns would diminish. Fiscal and monetary policies were likely to contribute significantly to aggregate demand in coming quarters. Participants expressed a variety of views about the strength and timing of the recovery, however. Some believed that the natural resilience of market forces would become evident later this year. Others, who saw recovery as delayed and potentially weak, were concerned about a possible further rise in the saving rate and a very slow improvement in financial conditions. Some participants also cautioned that, because of the poor functioning of the financial system, capital and labor were not being allocated to their most productive uses, and this failure threatened to damp the recovery and reduce the potential growth of the economy over the medium term.

Participants saw little chance of a pickup in inflation over the near term, as rising unemployment and falling capacity utilization were holding down wages and prices and inflation expectations appeared subdued. Several expressed concern that inflation was likely to persist below desired levels, with a few pointing to the risk of deflation. Even without a continuation of outright price declines, falling expectations of inflation would raise the real rate of interest and thus increase the burden of debt and further restrain the economy.

Some indicators, including share prices and CDS spreads of financial institutions, suggested a worsening of financial market strains since January. However, for the most part, participants viewed conditions in financial markets as little changed but remaining extraordinarily stressed. The large volume of issuance of investment-grade corporate bonds in recent weeks was a notable bright spot. Participants shared comments received from financial industry contacts on their experiences with and concerns about recent government programs to stabilize the financial system. These contacts feared that uncertainties about future actions the government might take and future regulations it might impose were making it more difficult to plan and were discouraging participation in government efforts to stabilize the financial system. Participants agreed that a credible and widely understood program to deal with the troubles of the banking system could help restore business and consumer confidence. Many viewed the strengthening of the banking system as essential for a sustained and robust recovery.

In the discussion of monetary policy for the intermeeting period, Committee members agreed that substantial additional purchases of longer-term assets eligible for open market operations would be appropriate. Such purchases would provide further monetary stimulus to help address the very weak economic outlook and reduce the risk that inflation could persist for a time below rates that best foster longer-term economic growth and price stability. One member preferred to focus additional purchases on longer-term Treasury securities, whereas another member preferred to focus on agency MBS. However, both could support expanded purchases across a range of assets, and several members noted that working across a range of assets and instruments was appropriate when the effects of any one tactic were uncertain. Members agreed that the monetary base was likely to grow significantly as a consequence of additional asset purchases; one, in particular, stressed that sustained increases in the monetary base were important to ensure that policy was consistently expansionary. Members expressed a range of views as to the preferred size of the increase in purchases. Several members felt that the significant deterioration in the economic outlook merited a very substantial increase in purchases of longer-term assets. In contrast, the potential for a large increase over time in the size of the balance sheet from the TALF program was seen as supporting a more modest, though still substantial, increase in asset purchases. Ultimately, members agreed to undertake additional purchases of agency MBS of up to $750 billion and of agency debt of up to $100 billion, and they also agreed to purchase up to $300 billion of longer-term Treasury securities. The Committee believed that purchases of these amounts would help to promote a return to economic growth and price stability. The period for conducting the agency debt and MBS purchases was extended from the next three months to the next nine months; members agreed to allow the Desk flexibility within this horizon to respond to market conditions. Treasury purchases were to be conducted over the next six months. Members also noted the recent launch of the TALF, and they agreed to include in the Committee's statement an indication that the range of assets accepted as eligible collateral for the TALF was likely to be expanded. Committee members decided to keep the target range for the federal funds rate at 0 to ¼ percent and to communicate to the public the Committee's view that the federal funds rate was likely to remain exceptionally low for an extended period.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase GSE debt, GSE-guaranteed MBS, and longer-term Treasury securities during the intermeeting period with the aim of providing support to private credit markets and economic activity. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of private credit market conditions. The Committee anticipates that the combination of outright purchases and various liquidity facilities outstanding will cause the size of the Federal Reserve's balance sheet to expand significantly in coming months. The Desk is expected to purchase up to $200 billion in housing-related GSE debt by the end of this year. The Desk is expected to purchase at least $500 billion in GSE-guaranteed MBS by the end of the second quarter of this year and is expected to purchase up to $1.25 trillion of these securities by the end of this year. The Committee also directs the Desk to purchase longer-term Treasury securities during the intermeeting period. Over the next six months, the Desk is expected to purchase up to $300 billion of longer-term Treasury securities. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in January indicates that the economy continues to contract. Job losses, declining equity and housing wealth, and tight credit conditions have weighed on consumer sentiment and spending. Weaker sales prospects and difficulties in obtaining credit have led businesses to cut back on inventories and fixed investment. U.S. exports have slumped as a number of major trading partners have also fallen into recession. Although the near-term economic outlook is weak, the Committee anticipates that policy actions to stabilize financial markets and institutions, together with fiscal and monetary stimulus, will contribute to a gradual resumption of sustainable economic growth.

In light of increasing economic slack here and abroad, the Committee expects that inflation will remain subdued. Moreover, the Committee sees some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.

In these circumstances, the Federal Reserve will employ all available tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide greater support to mortgage lending and housing markets, the Committee decided today to increase the size of the Federal Reserve's balance sheet further by purchasing up to an additional $750 billion of agency mortgage-backed securities, bringing its total purchases of these securities to up to $1.25 trillion this year, and to increase its purchases of agency debt this year by up to $100 billion to a total of up to $200 billion. Moreover, to help improve conditions in private credit markets, the Committee decided to purchase up to $300 billion of longer-term Treasury securities over the next six months. The Federal Reserve has launched the Term Asset-Backed Securities Loan Facility to facilitate the extension of credit to households and small businesses and anticipates that the range of eligible collateral for this facility is likely to be expanded to include other financial assets. The Committee will continue to carefully monitor the size and composition of the Federal Reserve's balance sheet in light of evolving financial and economic developments."

Voting for this action: Messrs. Bernanke and Dudley, Ms. Duke, Messrs. Evans, Kohn, Lacker, Lockhart, Tarullo, and Warsh, and Ms. Yellen.

Voting against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, April 28–29, 2009. The meeting adjourned at 1:35 p.m. on March 18, 2009.

Conference Call

On February 7, 2009, the Committee met by conference call in a joint session with the Board of Governors to discuss the potential role of the Federal Reserve in the Treasury's forthcoming financial stabilization plan. After hearing an overview of the version of the plan envisioned at the time of the meeting, meeting participants discussed its principal elements and shared a range of perspectives on its implications for financial markets and institutions. The Federal Reserve's primary direct role in the plan would be through an expansion of the previously announced TALF, which would be supported by additional funds from the Troubled Asset Relief Program (TARP). In the current environment, it was anticipated that such an expansion would provide additional assistance to financial markets and institutions in meeting the credit needs of households and businesses and thus would support overall economic activity. While several participants expressed some concern that the expansion of the TALF program could increase the Federal Reserve's exposure to credit risk, the program's requirements for highly rated collateral that would exceed the value of the related loans, in combination with the added TARP funds as a backstop against losses, were generally seen as providing the Federal Reserve with adequate protection. Participants also discussed the implications of the expanded TALF program for the Federal Reserve's balance sheet over time. Participants agreed it would be important to work with the Treasury to obtain tools to ensure that any reserves added to the banking system through this program could be removed at the appropriate time.

Notation Vote

By notation vote completed on February 17, 2009, the Committee unanimously approved the minutes of the FOMC meeting held on January 27–28, 2009.

Brian F. Madigan
Secretary

Meeting Held on April 28–29, 2009

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, April 28, 2009, at 2:00 p.m. and continued on Wednesday, April 29, 2009, at 9:00 a.m.

Present:

Mr. Bernanke, Chairman
Mr. Dudley, Vice Chairman
Ms. Duke
Mr. Evans
Mr. Kohn
Mr. Lacker
Mr. Lockhart
Mr. Tarullo
Mr. Warsh
Ms. Yellen

Mr. Bullard, Ms. Cumming, Mr. Hoenig, Ms. Pianalto, and Mr. Rosengren, Alternate Members of the Federal Open Market Committee

Messrs. Fisher, Plosser, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis, respectively

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Mr. Luecke, Assistant Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Sheets, Economist
Mr. Stockton, Economist

Messrs. Altig, Clouse, Connors, Kamin, Slifman, Sullivan, Wilcox, and Williams, Associate Economists

Ms. Mosser, Temporary Manager, System Open Market Account

Ms. Johnson, Secretary of the Board, Office of the Secretary, Board of Governors

Mr. Frierson,[7] Deputy Secretary, Office of the Secretary, Board of Governors

Mr. Struckmeyer, Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

Ms. Barger and Mr. English, Deputy Directors, Divisions of Banking Supervision and Regulation and Monetary Affairs, respectively, Board of Governors

Mr. Blanchard, Assistant to the Board, Office of Board Members, Board of Governors

Messrs. Levin, Nelson, Reifschneider, and Wascher, Associate Directors, Divisions of Monetary Affairs, Monetary Affairs, Research and Statistics, and Research and Statistics, respectively, Board of Governors

Mr. Meyer, Senior Adviser, Division of Monetary Affairs, Board of Governors

Mr. Carpenter, Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Palumbo, Assistant Director, Division of Research and Statistics, Board of Governors

7. Attended Wednesday's session only.

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Ms. Judson and Mr. Nichols,[8] Economists, Divisions of Monetary Affairs and Research and Statistics, respectively, Board of Governors

Ms. Beattie, Assistant to the Secretary, Office of the Secretary, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Mr. Barron, First Vice President, Federal Reserve Bank of Atlanta

Messrs. Rosenblum and Sniderman, Executive Vice Presidents, Federal Reserve Banks of Dallas and Cleveland, respectively

Mr. Hakkio, Ms. Mester, and Messrs. Rasche and Rolnick, Senior Vice Presidents, Federal Reserve Banks of Kansas City, Philadelphia, St. Louis, and Minneapolis, respectively

Messrs. Burke, Hornstein, and Olivei, Vice Presidents, Federal Reserve Banks of New York, Richmond, and Boston, respectively

Mr. Rich, Assistant Vice President, Federal Reserve Bank of New York

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on recent developments in domestic and foreign financial markets. The Manager also reported on System open market operations in Treasury securities and in agency debt and agency mortgage-backed securities (MBS) during the period since the Committee's March 17–18 meeting. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account over the intermeeting period.

The staff reported on recent developments in System liquidity programs and on changes in the System's balance sheet. As of April 22, the System's total assets and liabilities were close to $2.2 trillion, about $130 billion higher than just before the March meeting. System holdings of agency debt and agency MBS expanded by $215 billion over the same period. Credit extended through the Federal Reserve's liquidity facilities decreased, owing, at least in part, to the recent improvement in short-term funding markets.

The staff also provided the Committee with projections that were intended to illustrate the potential evolution of the Federal Reserve's balance sheet over coming years under a variety of assumptions about the economic and financial outlook and the associated path of monetary policy. The general contours of the projections—a rapid near-term increase in Federal Reserve assets and the monetary base, followed by a decline for a time—were the same in each case, but the timing and magnitude varied significantly depending upon the underlying assumptions. Moreover, many aspects of the economic and financial outlook were subject to substantial risks, implying considerable uncertainty regarding those assumptions and the resulting projections of the balance sheet and the monetary base.

The staff briefed the Committee on recent developments related to the Term Asset-Backed Securities Loan Facility (TALF), which was authorized by

8. Attended Tuesday's session only.

the Board of Governors last November under section 13(3) of the Federal Reserve Act. Under the TALF, the Federal Reserve Bank of New York extended three-year loans secured by AAA-rated asset-backed securities (ABS); these securities were backed by new and recently originated loans made by financial institutions. The first two monthly subscriptions of the TALF settled during the intermeeting period. At this meeting, the Committee discussed the potential benefits of accepting newly issued, AAA-rated commercial mortgage-backed securities and insurance premium finance ABS as eligible collateral for TALF loans. Meeting participants also discussed the possibility that some new TALF loans would have a longer maturity of five years.

Secretary's note: The Board of Governors subsequently approved the broadening of the list of TALF-eligible collateral and the addition of five-year loans to the facility, as announced on May 1, 2009.

By unanimous vote, the Committee decided to extend the reciprocal currency ("swap") arrangements with the Bank of Canada and the Banco de Mexico for an additional year, beginning in mid-December 2009; these arrangements are associated with the Federal Reserve's participation in the North American Framework Agreement of 1994. The arrangement with the Bank of Canada is in the amount of $2 billion equivalent, and that with the Banco de Mexico is in the amount of $3 billion equivalent. The vote to renew the System's participation in these swap arrangements was taken at this meeting because of the provision in the arrangements that requires each party to provide six months' prior notice of an intention to terminate its participation.

Staff Review of the Economic Situation

The information reviewed at the April 28–29 meeting indicated that the pace of decline in some components of final demand appeared to have slowed recently. Consumer spending firmed in the first quarter after dropping markedly during the second half of 2008. Housing activity remained depressed but seemed to have leveled off in February and March. In contrast, businesses cut production and employment substantially in recent months—likely reflecting, in part, inventory overhangs that persisted into the early part of the year—and fixed investment continued to contract. Headline and core consumer prices rose at a moderate pace over the first three months of the year.

Labor market conditions deteriorated further in March. Private nonfarm payroll employment registered its fifth consecutive large monthly decrease, with losses widespread across industries. Moreover, the average workweek of production and nonsupervisory workers on private payrolls ticked down in March from the low level recorded in January and February, and total hours worked for this group stayed below the fourth-quarter average. The civilian unemployment rate climbed to 8.5 percent, and the labor force participation rate edged down from its February level. The four-week moving average of initial claims for unemployment insurance remained elevated in April, and the number of individuals receiving unemployment benefits relative to the size of the labor force reached its highest level since 1982.

Industrial production fell substantially in March and for the first quarter as a whole, with cutbacks widespread across sectors, and manufacturing capacity utilization decreased to a very low level. First-quarter domestic production of light motor vehicles reached the lowest level in more than three decades as inventories of such vehicles, while low, remained high relative to sales. The output of high-technology products decreased in March and in the first quarter overall, with production of computers and semiconductors extending the downward trend that had begun in the second half of 2008. In contrast, the production of communications equipment edged up in the first quarter. The output of other consumer durables and business equipment stayed low, and broad indicators of near-term manufacturing activity suggested that factory output would contract over the next few months.

The available data suggested that real consumer spending rose moderately in the first quarter after having fallen in the second half of last year. Real spending on goods and services excluding motor vehicles fell in March but was up, on balance, for the first quarter as a whole. Real outlays on new and used motor vehicles expanded in the first quarter following six consecutive quarterly declines. Despite the upturn in consumer spending, the fundamentals for this sector remained weak: Wages and salaries dropped, house prices were markedly lower than a year ago, and, despite recent increases, equity prices were down substantially from their levels of 12 months earlier. As measured by the Reuters/University of Michigan survey, consumer sentiment strengthened a bit in early April, as households expressed somewhat more optimism about long-term economic conditions; however, even with this improvement, the measure was only slightly above the historical low for the series recorded last November.

The latest readings from the housing market suggested that the contraction in housing activity might have moderated over the first quarter. Single-family housing starts flattened out in February and March, and, after adjusting for activity outside of permit-issuing areas, the level of permits in March remained above the level of starts. The contraction in the multifamily sector also showed signs of slowing, as the drop in starts in the first quarter was well below the pace experienced during the fourth quarter of 2008. Recent data also indicated that housing demand might have stabilized. Sales of new single-family homes held steady in March after edging up in February, but the level of such sales remained low, leaving the supply of new homes relative to the pace of sales very high by historical standards. Existing home sales in March were slightly below the average pace for January and February. Most national indexes of house prices stayed on a downward trajectory. Lower mortgage rates and house prices contributed to an increase in housing affordability. Rates for conforming 30-year fixed-rate mortgages extended the significant decline that began late last year. Rates on jumbo loans came down as well, although the spread between the rates on jumbo and conforming loans was still wide and the market for private-label nonprime MBS remained impaired.

Real spending on equipment and software dropped markedly in the first quarter, with declines about as steep and widespread as in the fourth quarter of 2008. Orders and shipments of nondefense capital goods excluding aircraft fell in March, turning negative again after having been flat in February. The fundamental determinants of equipment and software investment stayed weak in the first quarter: Business output continued to drop sharply, and credit availability was still tight. In the April Senior Loan Officer Opinion Survey on Bank Lending Practices, the net percentages of respondents that reported they tightened their business lending policies over the previous three months, although continuing to be very elevated, edged down for the second consecutive survey. Real spending on nonresidential structures contracted in the first quarter. Despite the significant cuts in production in recent quarters, inventories remained sizable early in the year, although the overhang appeared to be less severe than in late 2008. Given the elevated level of inventories, firms continued their efforts to reduce their stocks.

The U.S. international trade deficit diminished in February to its lowest level since November 1999, as imports fell and exports rose a bit. Most major categories of exports increased, especially sales of consumer goods, and within that category, pharmaceuticals. Exports of capital goods rose despite a modest decrease in exports of aircraft, and exports of automotive products increased following a marked drop in January; in contrast, exports of services declined in February. All major categories of imports decreased. The fall in oil imports was driven by lower volumes as prices moved up slightly; prices of non-oil imports moved down, but falling volumes accounted for most of the decline in this category.

Economic conditions again worsened in the advanced foreign economies in the first quarter. Industrial production continued to drop through February, employment declined substantially, and retail sales were weak. However, indicators of developments late in the first quarter, particularly the purchasing managers indexes for all of the major advanced economies, increased, suggesting some moderation in the pace of contraction of economic activity going forward. The first-quarter data also offered a few tentative signs that the deceleration of economic activity in emerging markets might have started to abate. In particular, the growth of real gross domestic product (GDP) in China appeared to pick up on a quarterly basis following fiscal stimulus measures and steps to foster credit expansion.

In the United States, overall consumer prices increased over the first three months of 2009 after falling in the fourth quarter of 2008: Energy prices rebounded somewhat after their substantial late-year drop, and core prices picked up. In contrast, the producer price index for core intermediate materials fell, though at a noticeably slower pace than in late 2008. Indexes of commodity prices rose in March but stayed far below their year-earlier values. Near-term inflation expectations increased in early April but did not appear to influence longer-term expectations, whose levels in April were still at the low end of the range seen over the past few years. Hourly earnings of production and nonsupervisory workers edged up in March.

Staff Review of the Financial Situation

The decision by the Federal Open Market Committee (FOMC) at the March meeting to leave the target range for the federal funds rate unchanged was widely anticipated and had little effect on short-term money markets. However, investors were apparently surprised by the Committee's announcement that it would increase significantly further the size of the Federal Reserve's balance sheet by purchasing up to $300 billion in Treasury securities and expanding purchases of agency MBS and agency debt. In addition, market participants reportedly interpreted the statement that the federal funds rate was likely to remain exceptionally low "for an extended period" as stronger than the phrase "for some time" in the previous statement. Rates on Eurodollar futures contracts and yields on Treasury and agency securities fell considerably in response to the statement. The initial drop in the expected path for the federal funds rate was reversed over subsequent weeks, however, likely in response to the somewhat better economic outlook. Similarly, a portion of the substantial declines in yields on nominal Treasury coupon securities that followed the FOMC announcement was subsequently unwound amid the improved economic outlook, an easing of concern about financial institutions, and perhaps some reversal of flight-to-quality flows. Yields on inflation-indexed Treasury securities fell a bit more than those on their nominal counterparts, which decreased modestly, on net, over the period. As a result, inflation compensation rose at shorter horizons but changed little at longer horizons. Poor liquidity in the market for Treasury inflation-protected securities continued to make these readings difficult to interpret.

Conditions in short-term funding markets improved somewhat over the intermeeting period. In unsecured bank funding markets, spreads of dollar London interbank offered rates (Libor) over comparable-maturity overnight index swap (OIS) rates edged down, although Libor fixings beyond the one-month maturity stayed elevated. Spreads on A2/P2-rated commercial paper and AA-rated asset-backed commercial paper narrowed a bit, on net, staying at the low end of their respective ranges over the past year. Functioning in the repurchase agreement (repo) market showed additional improvement, as bid-asked spreads and "haircuts" on most collateral either narrowed or held steady, although repo volumes were still low. Consistent with modestly better conditions in the term repo market, all seven auctions under the Term Securities Lending Facility were undersubscribed over the intermeeting period, including two auctions that garnered no bids.

Trading conditions in the secondary market for nominal Treasury securities also showed some signs of improvement. Premiums paid for on-the-run Treasury securities fell, and average bid asked spreads for Treasury notes were relatively stable near their precrisis levels. Still, daily trading volumes for Treasury securities remained low.

Broad stock price indexes rose significantly, reportedly buoyed by announcements of policy measures to enhance credit markets and clean up banks' balance sheets and perhaps by some reduction in concerns about the economic outlook. Financial stocks outperformed broader markets, boosted by relatively favorable first-quarter earnings reports from a few major firms. The spread between the forward trend earnings-price ratio for S&P 500 firms and an estimate of the real long-run Treasury yield—a rough gauge of the equity risk premium—narrowed during the intermeeting period but was still very high by historical standards. Option-implied volatility on the S&P 500 index decreased but stayed well above historical norms.

On net, yields on lower-rated investment-grade and speculative-grade corporate bonds dropped, resulting in a narrowing of spreads in yields on such bonds over those on comparable-maturity Treasury securities. Even so, corporate bond spreads remained extremely high by historical standards.

Indicators of functioning in the corporate bond market—such as bid-asked spreads estimated by the staff—suggested that conditions in the speculative-grade segment of the market had become less strained since last autumn. Corresponding measures for investment-grade bonds hovered at moderately elevated levels. The leveraged loan market showed some improvement over the past few months, with the average bid-asked spread narrowing and the average bid price moving up from a very depressed level. The basis between an index of credit default swap spreads and measures of investment-grade corporate spreads—a rough proxy for unexploited arbitrage opportunities in the corporate credit market—stayed at high levels, reportedly reflecting an ongoing lack of financing capacity at major financial institutions. No issuance of commercial MBS occurred over the intermeeting period.

The debt of the domestic private nonfinancial sector appeared to have contracted in the first quarter at about the same pace as in the fourth quarter of 2008. Activity in the mortgage market reflected mainly refinancing, and staff estimates indicated that residential mortgage debt contracted again in the first quarter, depressed by the very low pace of home sales, falling house prices, and write-downs of nonperforming loans. Consumer credit was essentially flat in January and February. Expansion of nonfinancial business debt was tepid, as robust bond issuance was partly offset by declines in commercial paper and bank loans. Federal debt rose briskly in the first quarter.

M2 expanded rapidly in March. A strong increase in liquid deposits, the largest component of M2, likely reflected further reallocations by households toward safer assets. Retail money market mutual funds and small time deposits contracted modestly. Currency growth was apparently bolstered by elevated foreign demand.

Commercial bank credit contracted in March and was estimated to have dropped again in April. The decline in bank credit in March was due importantly to a decrease in loans to businesses that reflected, in part, paydowns with the proceeds of bond issuance. Commercial real estate loans also fell. Bank lending to households was weak, although credit extended under revolving home equity lines of credit again expanded robustly. Residential mortgage loans on banks' books fell, on balance, in March and the first part of April; banks reportedly sold a considerable amount of single-family mortgages to the government-sponsored enterprises. Consumer loans held by banks also shrank, amid heavy securitization. The Senior Loan Officer Opinion Survey conducted in April indicated that banks continued to tighten their credit standards and terms on all major loan categories over the previous three months.

Stock markets around the world rose substantially over the intermeeting period amid somewhat better sentiment regarding economic prospects, reports of better-than-expected performance from some financial firms in the United States and Europe, and continued support from monetary policies. Pressures in bank funding markets seemed to ease over the period: Spreads between both euro and sterling Libor and their respective OIS rates narrowed significantly, and financial conditions in most emerging market economies improved.

The dollar depreciated against the other major currencies in an environment of seemingly increased investor appetite for risk.

During the intermeeting period, foreign authorities took additional steps to address the weaknesses in their economies and financial systems. The European Central Bank and the Bank of Canada, along with several other central banks in both the advanced and emerging market economies, cut policy rates, while the Bank of England and the Bank of Japan continued their asset purchases to provide further monetary stimulus. Several governments, including Japan and Taiwan, announced new fiscal stimulus packages, and a number of European countries took additional measures to support their banking sectors.

Staff Economic Outlook

In the forecast for the meeting, which was prepared prior to the release of the advance estimates of the first-quarter national income and product accounts, the staff revised up its outlook for economic activity in response to recent favorable financial developments as well as better-than-expected readings on final sales. Consumer purchases appeared to have stabilized after falling in the second half of 2008, and the steep decline in the housing sector seemed to be abating. However, the contraction in the labor market persisted into March, industrial production again fell rapidly, and the broad-based decline in equipment and software investment continued. Conditions in financial markets improved more than had been expected: Private borrowing rates moved lower, stock prices rose substantially, and some measures of financial stress eased. The staff's projections for economic activity in the second half of 2009 and in 2010 were revised up, with real GDP expected to edge higher in the second half and then increase moderately next year. The key factors expected to drive the acceleration in activity were the boost to spending from fiscal stimulus, the bottoming out of the housing market, a turn in the inventory cycle from liquidation to modest accumulation, and ongoing gradual recovery of financial markets. The staff again expected that the unemployment rate would rise through the beginning of 2010 before edging down over the rest of that year. The staff forecast for overall and core personal consumption expenditures (PCE) inflation over the next two years was revised up slightly. The staff raised its near-term estimate of core PCE inflation because recent data on core and overall PCE price inflation came in a bit higher than anticipated. Beyond the near term, however, the staff anticipated that the low level of resource utilization and a gradual decline in inflation expectations would lead to a deceleration in core PCE prices. Looking out to 2011, the staff anticipated that financial markets and institutions would continue to recuperate, monetary policy would remain stimulative, fiscal stimulus would be fading, and inflation expectations would be relatively well anchored. Under such conditions, the staff projected that real GDP would expand at a rate well above that of its potential, that the unemployment rate would decline significantly, and that overall and core PCE inflation would stay in a low range.

Participants' Views and Committee Policy Action

In conjunction with this FOMC meeting, all meeting participants—the five members of the Board of Governors and the presidents of the 12 Federal Reserve Banks—provided projections for economic growth, the unemployment rate, and consumer price inflation for each year from 2009 through 2011 and over a longer horizon. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks. Participants' forecasts through 2011 and over the longer run are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In their discussion of the economic situation and outlook, participants agreed that the information received since the March meeting provided some tentative evidence that the pace of contraction in real economic activity was starting to diminish. Participants noted that financial market conditions had generally strengthened, and surveys and anecdotal reports pointed to a pickup in household and business confidence, which nonetheless remained at very low levels. Some signs pointing toward economic stabilization were seen in data on consumer spending, housing, and factory orders. Although economic activity was being damped by the efforts of businesses to pare excess inventories, the substantial drawdown in inventories over recent months was viewed as raising the prospects for a gradual expansion in industrial production later this year. Participants anticipated that the acceleration in final demand and economic activity over the next few quarters would be modest. Growth of consumption expenditures was likely to be restrained by the weakness in labor markets and the lagged effects of past reductions in household wealth. Business investment spending would probably shrink further. Adverse global economic and financial conditions would continue to weigh on the demand for U.S. exports.

Financial market developments over the intermeeting period were mainly seen as positive. Equity prices increased, money markets were functioning better, and corporate issuance of bonds and convertible securities was relatively brisk. Measures of volatility and financial stress moved down and risk spreads narrowed in many markets, perhaps partly because of investors' perceptions of diminished downside tail risks. Even so, risk spreads remained unusually wide and markets continued to be fragile. Despite the improvement in financial markets, credit conditions stayed quite restrictive for many households and businesses. The April Senior Loan Officer Opinion Survey showed that a large net fraction of banks had tightened their terms and standards for credit during the previous three months, albeit a modestly smaller fraction than indicated by the January survey. Moreover, meeting participants noted that the volume of credit extended to households and businesses was still contracting as a result of shrinking demand, declining credit quality, capital constraints on financial institutions, and the limited availability of financing through securitization markets.

Consumer spending firmed somewhat during the first quarter despite the rising unemployment rate and significant financial strains. Participants generally expected that household demand would gradually strengthen over coming quarters in response to the rise in household wealth from the substantial increase in equity prices that had occurred over the intermeeting period as well as the support for income provided by fiscal policy. Nevertheless, participants judged that the recovery in consumer demand over the next few quarters would be slow, reflecting adverse labor market conditions and continuing adjustments to earlier reductions in household wealth.

Some participants referred to the possibility that activity in the housing market might finally be approaching a trough. Indicators of new home sales appeared to be stabilizing, and inventories of unsold homes diminished somewhat. Participants also reported some signs that the decline in home prices might be slowing.

Labor market conditions were still deteriorating. Unemployment claims were exceptionally elevated, and the ratio of permanent job cuts to temporary layoffs was substantially higher than in previous economic downturns. Staff reductions were under way even at traditionally stable employers such as hospitals and nonprofit institutions. An unusually large proportion of employed persons indicated that they were engaged in part-time work because they could not obtain full-time jobs.

Participants cited the magnitude of the retrenchment in production and capital spending, but they also noted that manufacturing surveys and informal contacts suggested a noticeable upturn in business sentiment: A number of participants highlighted regional surveys reporting that greater numbers of industrial firms anticipated that their orders and shipments would start expanding over the next six months. Some participants expected that a gradual strengthening of retail sales would lead to an abatement of the decline in capital investment and would tend to induce manufacturers to begin rebuilding depleted stocks of inventories later this year, thereby reinforcing the pickup in industrial production. The outlook in some other sectors seemed less propitious; for example, one participant described survey data indicating that firms in the service sector were expecting sales to decrease further in coming months, and others referred to cutbacks in drilling and mining.

The economies of many key trading partners were seen as experiencing quite severe contractions. Participants noted that banking institutions in a number of countries remained exposed to substantial further losses, and the process of repairing the balance sheets of such institutions would likely continue to restrain growth in those economies over coming quarters and hence damp the outlook for U.S. export demand. A few countries did show some signs that weakness was abating, perhaps reflecting, in part, rapid implementation of fiscal stimulus; furthermore, the recent firming of commodity prices gave an indication that global weakness might be starting to subside.

Although the near-term economic outlook had improved modestly since March, participants emphasized the tentative nature of the incoming data, which are volatile and subject to revision. The experience of previous recessions underscored the challenges of identifying the onset of economic recovery using real-time indicators. Also, empirical analysis of past episodes in the United States and abroad in which economic downturns had been triggered by financial crises generally concluded that such contractions tended to be more severe and protracted than other recessions. Moreover, participants continued to see significant downside risks to the economic outlook. In particular, while financial strains and risk spreads had lessened somewhat over the intermeeting period, participants agreed that the global financial system remained vulnerable to further shocks.

In discussing the Supervisory Capital Assessment Program, which was being conducted jointly by the Federal Reserve and other bank supervisory authorities, a number of participants noted that investors were concerned that the upcoming publication of stress test results might trigger volatility in financial markets. Some participants also referred to mounting losses in commercial real estate, which could have substantial adverse consequences for regional banks and other financial institutions with significant concentrations of such assets.

Looking further ahead, participants considered a number of factors that would be likely to restrain the pace of economic recovery over the medium term. Strains in credit markets were expected to recede only gradually as financial institutions continued to rebuild their capital and remained cautious in their approach to asset-liability management, especially given that the outlook for credit performance was likely to improve slowly. Some sectors—such as financial services and residential construction—might well account for a smaller share of the economy in coming years, and the resulting reallocation of labor across sectors could weigh on labor markets for some time. Households would likely remain cautious, and their desired saving rates would be relatively high over the extended period that would be required to bring their stock of wealth back up to more normal levels relative to income. The stimulus from fiscal policy was expected to diminish over time as the government budget moved to a sustainable path. Demand for U.S. exports would also take time to revive, reflecting the gradual recovery of major trading partners.

Most participants expected inflation to remain subdued over the next few years, and they saw some risk that elevated unemployment and low capacity utilization could cause inflation to remain persistently below the rates that they judged as most consistent with sustainable economic growth and price stability. Nonetheless, recent monthly readings on consumer price inflation had been above the low rates observed late last year, and survey measures of longer-run inflation expectations had remained reasonably stable, leading many participants to judge that the risk of a protracted period of deflation had diminished. Some participants highlighted the potential pitfalls of making inflation projections based on contemporaneously available measures of resource slack, especially during periods when the economy was facing large supply shocks and significant sectoral reallocation. Several participants referred to contacts who had expressed concerns that the expansion of the Federal Reserve's balance sheet might not be reversed in a sufficiently timely manner and hence that inflation could rise above rates consistent with price stability.

In their discussion of monetary policy for the intermeeting period, Committee members agreed that the Federal Reserve's large-scale securities purchases were providing financial stimulus that would contribute to the gradual resumption of sustainable economic growth in a context of price stability. Members also agreed that it would be appropriate to continue making purchases in accordance with the amounts that had previously been announced—that is, up to $1.25 trillion of agency MBS and up to $200 billion of agency debt by the end of this year, and up to $300 billion of Treasury securities by autumn. Some members noted that a further increase in the total amount of purchases might well be warranted at some point to spur a more rapid pace of recovery; all members concurred with waiting to see how the economy and financial conditions respond to the policy actions already in train before deciding whether to adjust the size or timing of asset purchases. The Committee reaffirmed the need to monitor carefully the size and composition of the Federal Reserve's balance sheet in light of economic and financial developments. The Committee also discussed its strategy for communicating the anticipated path of its asset purchases and the circumstances under which adjustments to that path would be appropriate. All members agreed that the statement should note that the timing and overall amounts of the Committee's asset purchases would continue to be evaluated in light of the evolving economic outlook and conditions in financial markets.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase agency debt, agency MBS, and longer-term Treasury securities during the intermeeting period with the aim of providing support to private credit markets and economic activity. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of private credit market conditions. The Committee anticipates that the combination of outright purchases and various liquidity facilities outstanding will cause the size of the Federal Reserve's balance sheet to expand significantly in coming months. The Desk is expected to purchase up to $200 billion in housing-related agency debt by the end of this year. The Desk is expected to purchase at least $500 billion in agency MBS by the end of the second quarter of this year and is expected to purchase up to $1.25 trillion of these securities by the end of this year. The Desk is expected to purchase up to $300 billion of longer-term Treasury securities by the end of the third quarter. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in March indicates that the economy has continued to contract, though the pace of contraction appears to be somewhat slower. Household spending has shown signs of stabilizing but remains constrained by ongoing job losses, lower housing wealth, and tight credit. Weak sales prospects and difficulties in obtaining credit have led businesses to cut back on inventories, fixed investment, and staffing. Although the economic outlook has improved modestly since the March meeting, partly reflecting some easing of financial market conditions, economic activity is likely to remain weak for a time. Nonetheless, the Committee continues to anticipate that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will contribute to a gradual resumption of sustainable economic growth in a context of price stability.

In light of increasing economic slack here and abroad, the Committee expects that inflation will remain subdued. Moreover, the Committee sees some risk that inflation could persist for a time below rates that best foster economic growth and price stability in the longer term.

In these circumstances, the Federal Reserve will employ all available tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and anticipates that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period. As previously announced, to provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve will purchase a total of up to $1.25 trillion of agency mortgage-backed securities and up to $200 billion of agency debt by the end of the year. In addition, the Federal Reserve will buy up to $300 billion of Treasury securities by autumn. The Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. The Federal Reserve is facilitating the extension of credit to households and businesses and supporting the functioning of financial markets through a range of liquidity programs. The Committee will continue to carefully monitor the size and composition of the Federal Reserve's balance sheet in light of financial and economic developments."

> Voting for this action: Messrs. Bernanke and Dudley, Ms. Duke, Messrs. Evans, Kohn, Lacker, Lockhart, Tarullo, and Warsh, and Ms. Yellen.
>
> Voting against this action: None.

Governor Kohn reported to the Committee on the progress of a Federal Reserve workgroup in its review of the information provided to the public regarding Federal Reserve programs and activities. That review was being conducted to identify opportunities for providing additional information to the public without compromising the Federal Reserve's mandated policy objectives. The workgroup had been devoting particular attention to approaches to enhancing the transparency of the Federal Reserve's liquidity and credit facilities, including regular reporting on the number, types, and concentration of borrowers from each program; the amount and nature of collateral accepted; detailed background information on special purpose vehicles; and contracts with private-sector firms that had been engaged to help carry out some of these programs. In the Committee's discussion of these issues, it was noted that disclosing the identities of individual borrowers would very likely discourage use of the Federal Reserve's liquidity and credit facilities because prospective borrowers would be concerned that their creditors and counterparties would see borrowing from the Federal Reserve as a sign of financial weakness. The resulting stigma would undermine the effectiveness of those programs in promoting financial stability and economic recovery.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, June 23–24, 2009. The meeting adjourned at 11:50 a.m. on April 29, 2009.

Notation Vote

By notation vote completed on April 7, 2009, the Committee unanimously approved the minutes of the FOMC meeting held on March 17–18, 2009.

Brian F. Madigan
Secretary

Addendum: Summary of Economic Projections

In conjunction with the April 28–29, 2009, FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in deliberations of the FOMC, submitted projections for output growth, unemployment, and inflation in 2009, 2010, 2011, and over the longer run. Projections were based on information available through the end of the meeting and on each participant's assumptions about factors likely to affect economic outcomes, including his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future path of policy that the participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her interpretation of the Federal Reserve's dual objectives of maximum employment and stable prices. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

As indicated in table 1 and depicted in figure 1, all FOMC participants projected that real GDP would contract this year, that the unemployment rate would increase in coming quarters, and that inflation would be slower this year than in recent years. Almost all participants viewed the near-term outlook for economic activity as having weakened relative to the projections they made at the time of the January FOMC meeting, but they continued to expect a recovery in sales and production to begin during the second half of 2009. With the strong adverse forces that have been acting on the economy likely to abate only slowly, participants generally expected a gradual recovery: All anticipated that unemployment, though declining in coming years, would remain well above its longer-run sustainable rate at the end of 2011; most indicated they expected the economy to take five or six years to converge to a longer-run path characterized by a sustainable rate of output growth and by rates of unemployment and inflation consistent with the Federal Reserve's dual objectives, but several said full convergence would take longer. Participants projected very low inflation this year; most expected inflation to edge up over the next few years toward the rate they consider consistent with the dual objectives. Most par-

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, April 2009

Percent

Variable	Central tendency[1]				Range[2]			
	2009	2010	2011	Longer Run	2009	2010	2011	Longer Run
Change in real GDP	−2.0 to −1.3	2.0 to 3.0	3.5 to 4.8	2.5 to 2.7	−2.5 to −0.5	1.5 to 4.0	2.3 to 5.0	2.4 to 3.0
January projection	−1.3 to −0.5	2.5 to 3.3	3.8 to 5.0	2.5 to 2.7	−2.5 to 0.2	1.5 to 4.5	2.3 to 5.5	2.4 to 3.0
Unemployment rate	9.2 to 9.6	9.0 to 9.5	7.7 to 8.5	4.8 to 5.0	9.1 to 10.0	8.0 to 9.6	6.5 to 9.0	4.5 to 5.3
January projection	8.5 to 8.8	8.0 to 8.3	6.7 to 7.5	4.8 to 5.0	8.0 to 9.2	7.0 to 9.2	5.5 to 8.0	4.5 to 5.5
PCE inflation	0.6 to 0.9	1.0 to 1.6	1.0 to 1.9	1.7 to 2.0	−0.5 to 1.2	0.7 to 2.0	0.5 to 2.5	1.5 to 2.0
January projection	0.3 to 1.0	1.0 to 1.5	0.9 to 1.7	1.7 to 2.0	−0.5 to 1.5	0.7 to 1.8	0.2 to 2.1	1.5 to 2.0
Core PCE inflation[3]	1.0 to 1.5	0.7 to 1.3	0.8 to 1.6		0.7 to 1.6	0.5 to 2.0	0.2 to 2.5	
January projection	0.9 to 1.1	0.8 to 1.5	0.7 to 1.5		0.6 to 1.5	0.4 to 1.7	0.0 to 1.8	

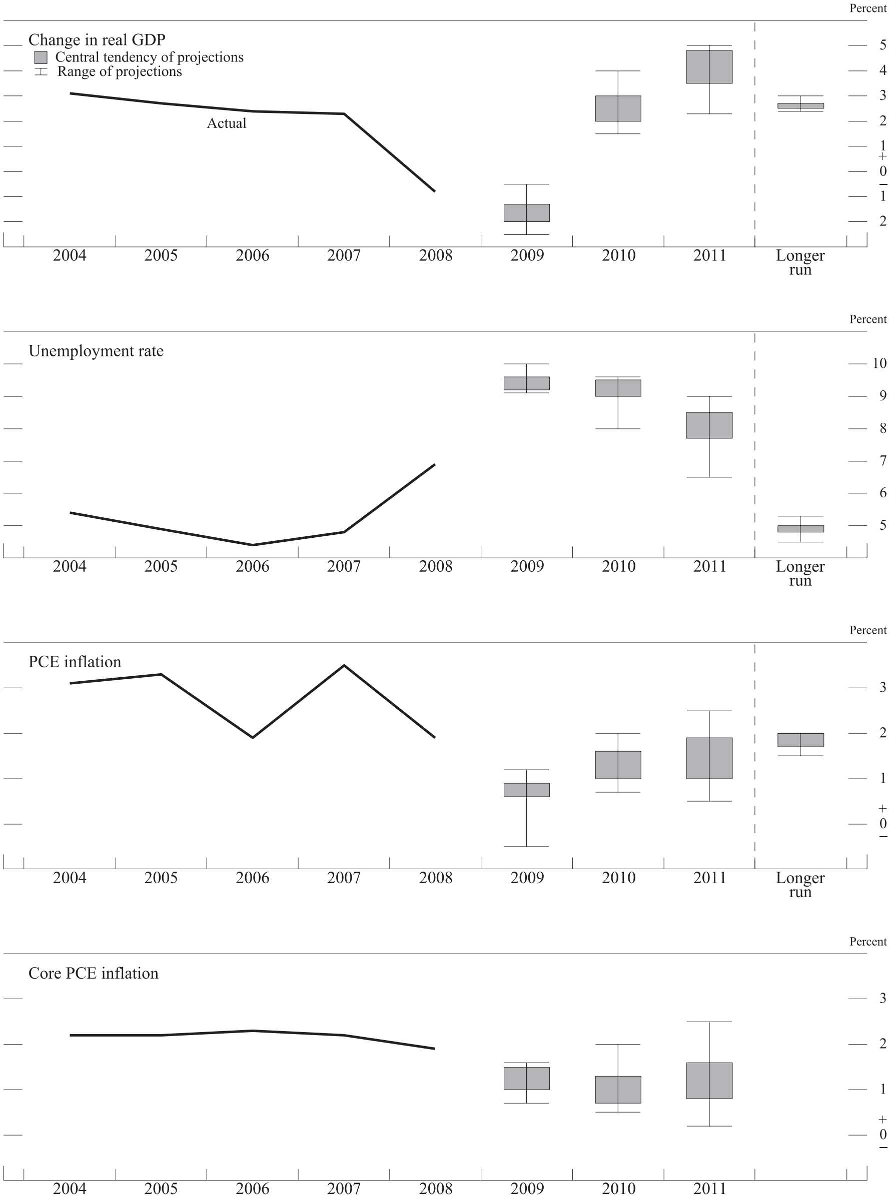
NOTE: Projections of change in real gross domestic product (GDP) and of inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The January projections were made in conjunction with the FOMC meeting on January 27–28, 2009.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.

2. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.

3. Longer-run projections for core PCE inflation are not collected.

Figure 1. Central tendencies and ranges of economic projections, 2009–11 and over the longer run



NOTE: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual.

ticipants—though fewer than in January—viewed the risks to the growth outlook as skewed to the downside. Most participants saw the risks to the inflation outlook as balanced; fewer than in January viewed those risks as tilted to the downside. With few exceptions, participants judged that their projections for economic activity and inflation remained subject to a degree of uncertainty exceeding historical norms.

The Outlook

Participants' projections for 2009 real GDP growth had a central tendency of negative 2.0 percent to negative 1.3 percent, somewhat below the central tendency of negative 1.3 percent to negative 0.5 percent for their January projections. Participants noted that the data received between the January and April FOMC meetings pointed to a larger decline in output and employment during the first quarter than they had anticipated at the time of the January meeting. However, participants also saw recent indications that the economic downturn was slowing in the second quarter, and they continued to expect that sales and production would begin to recover—albeit gradually—during the second half of the year, reflecting the effects of monetary and fiscal stimulus and of measures to support credit markets and stabilize the financial system along with market forces. In particular, participants noted some improvement in financial conditions in recent months, signs that consumer spending was leveling out, and tentative indications that activity in the housing sector might be nearing its bottom. In addition, they observed that the large reduction in stocks of unsold goods that resulted from firms' aggressive inventory cutting during the first quarter would make firms more likely to increase production as their sales stabilize and then begin to turn up later this year. Participants expected, however, that recoveries in consumer spending and residential investment initially would be damped by further deterioration in labor markets, still-tight credit conditions, and a continuing, if less pronounced, decline in house prices. Moreover, they anticipated that very low capacity utilization, sluggish growth in sales, and the high cost and limited availability of financing would contribute to further weakness in business fixed investment this year.

Looking further ahead, participants' projections for real GDP growth in 2010 had a central tendency of 2.0 to 3.0 percent, and those for 2011 had a central tendency of 3.5 to 4.8 percent. Participants generally expected that strains in credit markets and in the banking system would ebb slowly, and hence that the pace of recovery would continue to be damped in 2010. But they anticipated that the upturn would strengthen in 2011 to a pace exceeding the growth rate of potential GDP as financial conditions continue to improve, and that it would remain above that rate long enough to eliminate slack in resource utilization over time. Several participants anticipated that rapid growth in the monetary base in 2009—a result of the Federal Reserve's sizable purchases of longer-term assets—would result in a more pronounced pickup in output and employment growth in 2010 and a somewhat quicker convergence to longer-run equilibrium. Most participants expected that, absent further shocks, real GDP growth eventually would converge to a rate of 2.5 to 2.7 percent per year, reflecting longer-term trends in the growth of productivity and the labor force.

In light of their expectation that the recovery will begin gradually, with output initially rising at a below-potential rate, participants anticipated that labor market conditions would continue to deteriorate over the remainder of this year. Their projections for the average unemployment rate during the fourth quarter of 2009 had a central tendency of 9.2 to 9.6 percent, noticeably higher than the actual unemployment rate of 8.5 percent in March—the latest reading available at the time of the April FOMC meeting. All participants revised up their forecasts of the unemployment rate at the end of this year relative to their January projections, reflecting the sharper-than-expected rise in actual unemployment that occurred during the first quarter as well as the downward revisions in their forecasts of output growth in 2009. Most participants anticipated that growth next year would not substantially exceed its longer-run sustainable rate and hence that the unemployment rate would decline only modestly in 2010; some also pointed to the friction of a reallocation of resources away from shrinking economic sectors as likely to restrain progress in reducing unemployment. With output growth and job creation generally projected to pick up appreciably in 2011, participants anticipated that joblessness would decline more noticeably, as evident from the central tendency of 7.7 to 8.5 percent for their projections of the unemployment rate in late 2011. Even so, they expected that the unemployment rate at the end of 2011 would still be declining toward its longer-run sustainable level. Participants projected that unemployment would decline further after 2011; most saw the unemployment rate eventually converging to 4.8 to 5.0 percent.

The central tendency of participants' projections for 2009 PCE inflation was 0.6 to 0.9 percent, an interval that is somewhat narrower but neither higher nor lower than the central tendency of their January projections. Looking beyond this year, participants' projections for total PCE inflation had central tendencies of 1.0 to 1.6 percent for 2010 and 1.0 to 1.9 percent for 2011. The central tendency of projections for core inflation in 2009 was 1.0 to 1.5 percent; those for 2010 and 2011 were 0.7 to 1.3 percent and 0.8 to 1.6 percent, respectively. Most participants expected that economic slack, though diminishing, would continue to damp inflation pressures for the next few years and hence that total PCE inflation in 2011 would still be below their assessments of its appropriate longer-run level. Some thought that persistent economic slack would be accompanied by declining inflation over the next few years. Most, however, projected that, as the economy recovers, inflation would increase gradually and move toward their individual assessments of the measured rate of inflation consistent with the Federal Reserve's dual mandate for maximum employment and price stability. Several participants, noting that the public's longer-run inflation expectations have not changed appreciably, anticipated that inflation would return more promptly to levels consistent with their judgments about appropriate longer-run inflation.

In April as in January, the central tendency of projections of the longer-run inflation rate was 1.7 to 2.0 percent. Most participants judged that a longer-run PCE inflation rate of 2 percent would be consistent with the Federal Reserve's dual mandate; others indicated that inflation of 1½ or 1¾ percent would be appropriate. Modestly positive longer-run inflation would allow the Committee to stimulate economic activity and support employment by setting the federal funds rate temporarily below the inflation rate when the economy suffers a large negative shock to demands for goods and services.

Uncertainty and Risks

A majority of participants continued to view the risks to their projections for real GDP growth as skewed to the downside and saw the associated risks to their projections for the unemployment rate as tilted to the upside, but a larger number than in January now saw the risks as broadly balanced. Participants shared the judgment that their projections of future economic activity and unemployment continued to be subject to greater-than-average uncertainty.[9] Some participants highlighted the still-considerable uncertainty about the future course of the financial crisis and the risk that a resurgence of financial turmoil could adversely impact the real economy. In addition, some noted the difficulty in gauging the macroeconomic effects of the credit-easing policies that are now being employed by the Federal Reserve and other central banks, given limited experience with such tools.

Most participants judged the risks to the inflation outlook as roughly balanced; some continued to view these risks as skewed to the downside, while one saw inflation risks as tilted to the upside. Some participants noted the risk that inflation expectations might become unanchored and drift downward in response to persistently low inflation outcomes; several pointed to the possibility of an upward shift in expected and actual inflation if investors become concerned that stimulative monetary policy measures and the attendant expansion of the Federal Reserve's balance sheet might not be unwound in a timely fashion as the economy recovers. Most participants again saw the uncertainty surrounding their inflation projections as exceeding historical norms.

9. Table 2 provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1989 to 2008. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risks attending participants' projections.

Table 2. Average historical projection error ranges

Percentage points

Variable	2009	2010	2011
Change in real GDP[1]	±1.0	±1.5	±1.6
Unemployment rate[1]	±0.5	±0.8	±1.0
Total consumer prices[2]	±0.8	±1.0	±1.0

NOTE: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1989 through 2008 that were released in the spring by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1. For definitions, refer to general note in table 1.

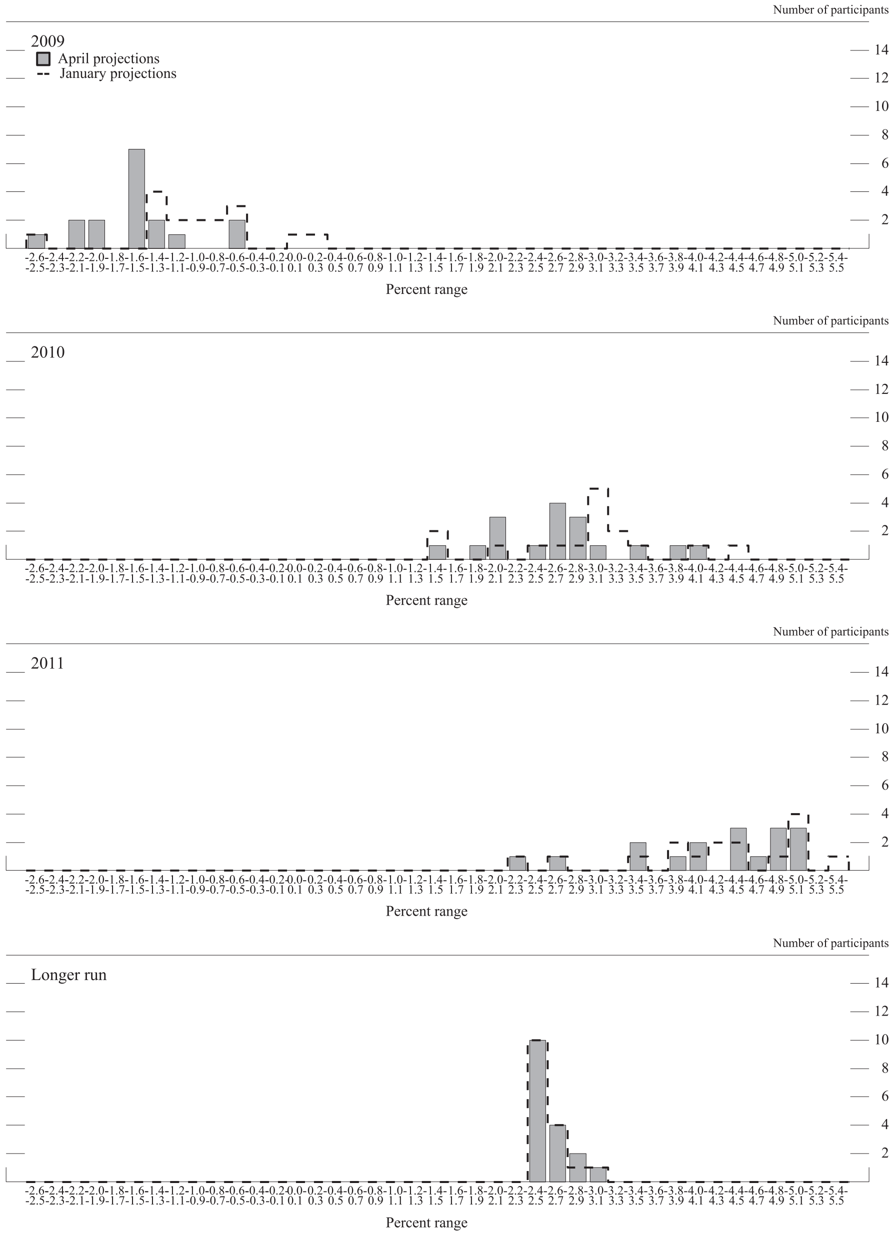
2. Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

Diversity of Views

Figures 2.A and 2.B provide further details on the diversity of participants' views regarding likely outcomes for real GDP growth and the unemployment rate in 2009, 2010, and 2011. The dispersion in participants' April projections reflects, among other factors, the diversity of their assessments regarding the effects of fiscal stimulus and the likely pace of recovery in the financial sector. Though the dispersion in projections for each variable was roughly the same in April as in January, the downward shift in the distribution of participants' projections of real GDP growth in 2009, coupled with essentially unchanged distributions of projections for growth in 2010 and 2011, resulted in an upward shift from January to April in the distribution of projections for the unemployment rate in all three years. The dispersion in participants' longer-run projections reflected differences in their estimates regarding the sustainable rates of output growth and unemployment to which the economy would converge under appropriate policy and in the absence of any further shocks; these distributions did not change appreciably from January to April.

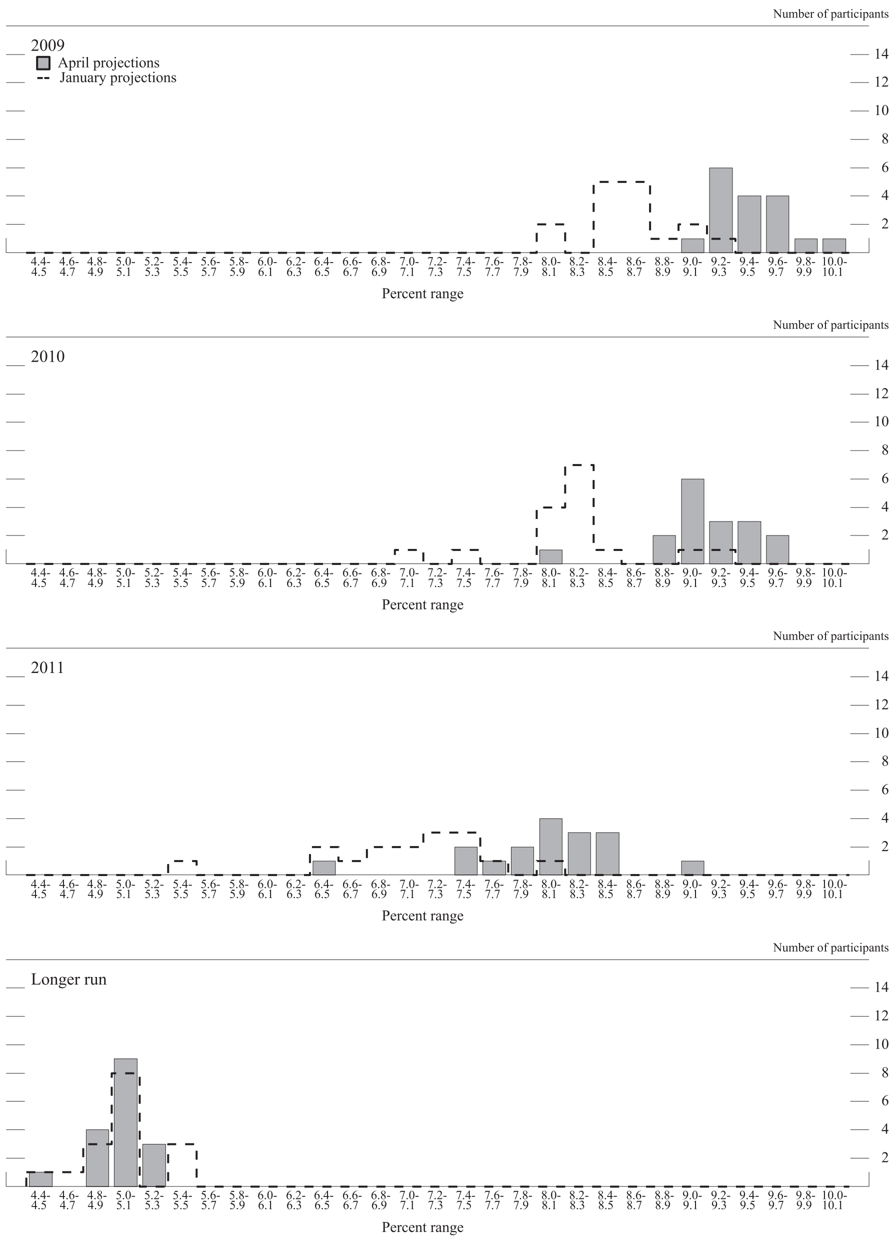
Figures 2.C and 2.D provide corresponding information about the diversity of participants' views regarding the inflation outlook. The dispersion in participants' projections for total and core PCE inflation during 2009 and the following two years illustrates their varying assessments of the inflation outcomes that will result from persistent economic slack, from expansion and subsequent contraction of the Federal Reserve's balance sheet, and perhaps also from changes in the public's expectations of future inflation. In contrast, the tight distribution of participants' projections for longer-run inflation illustrates their substantial agreement about the measured rate of inflation that is most consistent with the Federal Reserve's dual objectives of maximum employment and stable prices.

Figure 2.A. Distribution of participants' projections for the change in real GDP, 2009–11 and over the longer run



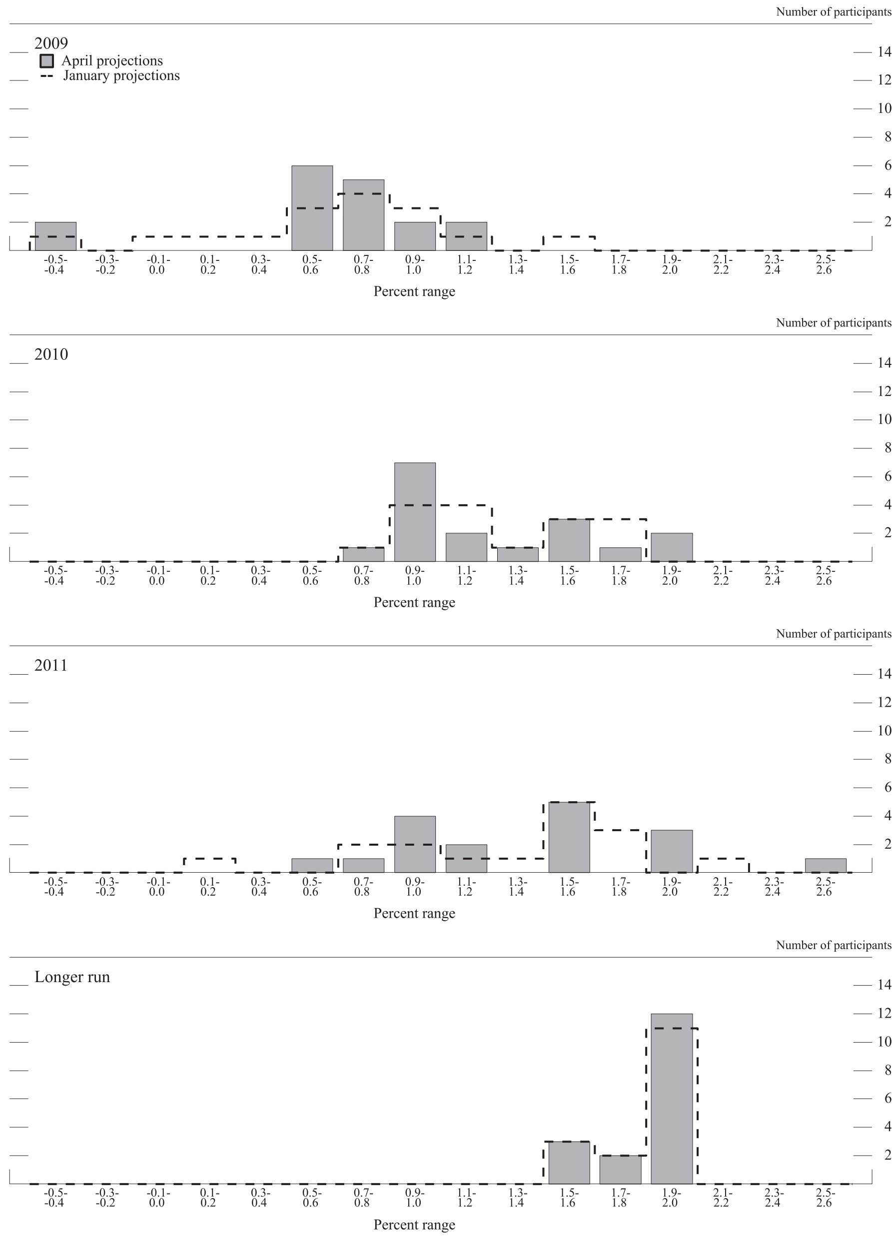
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of participants' projections for the unemployment rate, 2009–11 and over the longer run



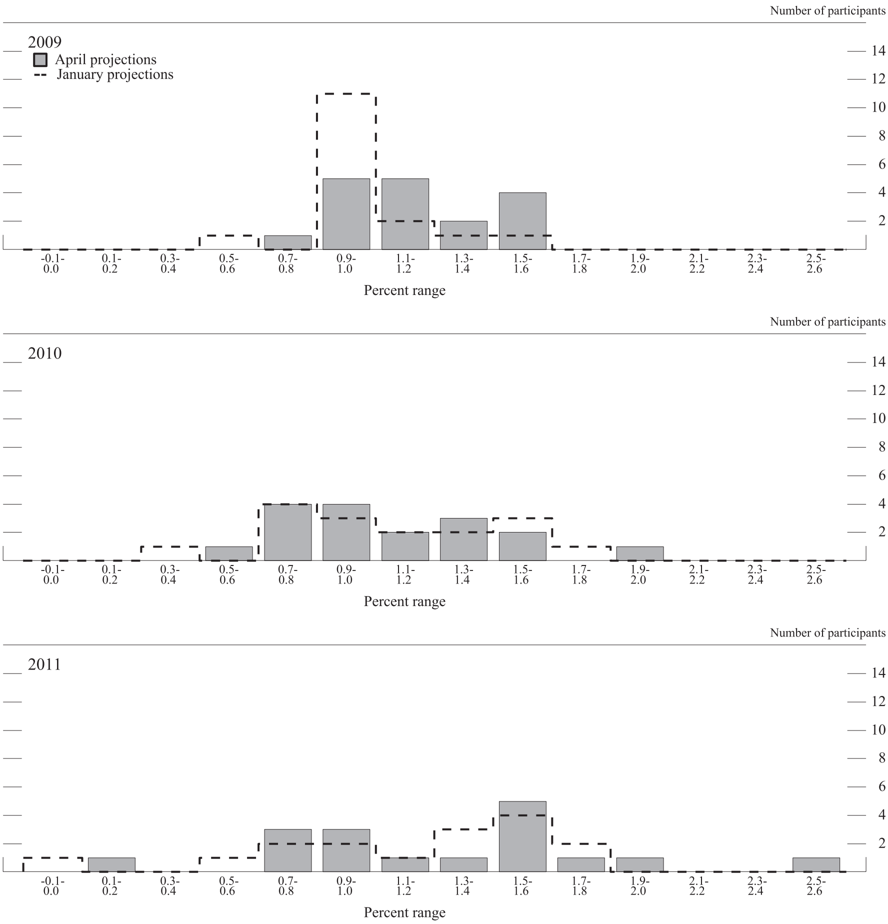
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of participants' projections for PCE inflation, 2009–11 and over the longer run



NOTE: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of participants' projections for core PCE inflation, 2009–11



NOTE: Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand between 2 percent to 4 percent in the current year, 1.5 percent to 4.5 percent in the second year, and 1.4 percent to 4.6 percent in the third year. The corresponding 70 percent confidence intervals for overall inflation would be 1.2 percent to 2.8 percent in the current year and 1.0 percent to 3.0 percent in the second and third years.

Because current conditions may differ from those that prevailed on average over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection, rather than with divergences across a number of different projections.

Meeting Held on June 23–24, 2009

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, June 23, 2009, at 1:00 p.m. and continued on Wednesday, June 24, 2009, at 9:00 a.m.

Present:

Mr. Bernanke, Chairman
Mr. Dudley, Vice Chairman
Ms. Duke
Mr. Evans
Mr. Kohn
Mr. Lacker
Mr. Lockhart
Mr. Tarullo
Mr. Warsh
Ms. Yellen

Messrs. Bullard and Hoenig, Ms. Pianalto, and Mr. Rosengren, Alternate Members of the Federal Open Market Committee

Messrs. Fisher, Plosser, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis, respectively

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Mr. Luecke, Assistant Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez,[10] General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Sheets, Economist
Mr. Stockton, Economist

Messrs. Altig, Clouse, Connors, Kamin, Slifman, Weinberg, and Wilcox, Associate Economists

Mr. Sack, Manager, System Open Market Account

Ms. Johnson, Secretary of the Board, Office of the Secretary, Board of Governors

Mr. Frierson,[10] Deputy Secretary, Office of the Secretary, Board of Governors

Mr. Struckmeyer, Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

Mr. English, Deputy Director, Division of Monetary Affairs, Board of Governors

Mr. Blanchard, Assistant to the Board, Office of Board Members, Board of Governors

Messrs. Greenlee, Nelson, Reifschneider, and Wascher, Associate Directors, Divisions of Banking Supervision and Regulation, Monetary Affairs, Research and Statistics, and Research and Statistics, respectively, Board of Governors

Mr. Gagnon, Visiting Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Oliner, Senior Adviser, Division of Research and Statistics, Board of Governors

Messrs. Carpenter and Perli, Deputy Associate Directors, Division of Monetary Affairs, Board of Governors

Mr. Kiley, Assistant Director, Division of Research and Statistics, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Ms. Lindner, Group Manager, Division of Research and Statistics, Board of Governors

Mr. Wood, Senior Economist, Division of International Finance, Board of Governors

Messrs. Driscoll, King,[10] and McCarthy, Economists, Division of Monetary Affairs, Board of Governors

10. Attended Tuesday's session only.

Ms. Beattie, Assistant to the Secretary, Office of the Secretary, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Messrs. Fuhrer and Rosenblum, Executive Vice Presidents, Federal Reserve Banks of Boston and Dallas, respectively

Mr. Judd, Advisor to the President, Federal Reserve Bank of San Francisco

Messrs. Feldman, Hilton, Krane, McAndrews, Mses. Mester and Mosser, and Messrs. Schweitzer, Sellon, and Waller, Senior Vice Presidents, Federal Reserve Banks of Minneapolis, New York, Chicago, New York, Philadelphia, New York, Cleveland, Kansas City, and St. Louis, respectively

Ms. Logan, Vice President, Federal Reserve Bank of New York

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account (SOMA) reported on recent developments in domestic and foreign financial markets. The Manager also reported on System open market operations in Treasury securities and in agency debt and agency mortgage-backed securities (MBS) during the period since the Committee's April 28–29 meeting. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account over the intermeeting period.

The Committee reviewed a staff proposal that would authorize the Desk to lend, as part of the Federal Reserve's regular overnight securities lending operations, securities held in the SOMA portfolio that are direct obligations of federal agencies. Lending agency securities was viewed as a technical modification to the existing overnight securities lending program that would support functioning of agency debt markets. The Committee voted unanimously to amend paragraph 3 of the Authorization for Domestic Open Market Operations with the text underlined below.

"3. In order to ensure the effective conduct of open market operations, the Federal Open Market Committee authorizes the Federal Reserve Bank of New York to lend on an overnight basis U.S. Government securities <u>and securities that are direct obligations of any agency of the United States</u>, held in the System Open Market Account, to dealers at rates that shall be determined by competitive bidding. The Federal Reserve Bank of New York shall set a minimum lending fee consistent with the objectives of the program and apply reasonable limitations on the total amount of a specific issue that may be auctioned and on the amount of securities that each dealer may borrow. The Federal Reserve Bank of New York may reject bids which could facilitate a dealer's ability to control a single issue as determined solely by the Federal Reserve Bank of New York."

The staff reported on projections of the Federal Reserve's balance sheet under various assumptions about economic and financial conditions and the associated path of monetary policy. Staff projections suggested that the size of the Federal Reserve's balance sheet might peak late this year and decline gradually thereafter. The staff also presented information on the possible implications of substantial changes in the size and composition of the Federal Reserve's balance sheet for the System's net income. The analysis indicated that the Federal Reserve was likely to earn substantial net interest income over the next few years under most interest rate scenarios. The staff presented one scenario, however, in which aggressive increases in short-term interest rates significantly reduced System net income relative to a baseline scenario. The analysis also suggested that the market value of the Federal Reserve's securities holdings could decline appreciably under some scenarios. However, while the Federal Reserve would retain the option of selling securities before they mature or are prepaid as a means of tightening policy when appropriate, it was not expected to have to do so. Changes in market valuations were thus seen as unlikely to have significant implications for the System's net income.

In a related discussion, the staff briefed the Committee on a number of possible tools that the Federal Reserve might employ to foster effective control of the federal funds rate in the context of a much expanded balance sheet. Some of those tools were focused primarily on shaping or strengthening the demand for reserves, while others were designed to provide greater control over the supply of reserves. In discussing the staff presentation, meeting participants generally agreed that the Federal Reserve either already had or could develop tools to remove policy accommodation when appropriate. Ensuring that policy accommodation can ultimately be withdrawn smoothly and at the appropriate time would remain a top priority of the Federal Reserve.

The staff also provided the Committee with an analysis of the potential adverse effects of very high reserve balances on bank capital ratios. An important issue was whether the further increase in reserve balances that is likely to result from the Federal Reserve's already-announced program of asset purchases could lead banks to limit their lending and acquisition of securities in order to prevent an excessive decline in their capital ratios. The analysis concluded that, with few exceptions, banks' regulatory leverage ratios (defined as tier 1 capital divided by total average assets) were likely to remain comfortably above regulatory minimums, even with the substantial growth in reserve balances projected to occur in coming months and even if there were some erosion in bank capital. In part, that result reflected the fact that many institutions had raised capital lately; in addition, the leverage ratios for most institutions were well above the regulatory minimums at the end of the first quarter.

The staff also reviewed the experience to date with the Federal Reserve's purchases of Treasury securities, agency debt securities, and agency MBS. A number of potential modifications to those programs were presented for the Committee's consideration, including possible expansions in their size, extensions of the duration of securities purchased, steps to increase the flexibility of those purchases both within each program and across programs in response to short-term market developments, and possible approaches to winding down purchases as the programs near completion. The Federal Reserve was already purchasing a very large fraction of new current-coupon agency MBS and agency debt, and further increasing the scale of those programs could compromise market functioning. Some participants thought that increases in purchases of Treasury securities might have little or no effect on long-term interest rates unless the increases were very sizable, given the large amount of current and projected supply of Treasury securities. Others were concerned that announcements of substantial additional purchases could add to perceptions that the federal debt was being monetized. While most members did not see large-scale purchases of Treasury securities as likely to be a source of inflation pressures given the weak economic outlook, public concern about monetization could have adverse implications for inflation expectations. The asset purchase programs were intended to support economic activity by improving market functioning and reducing interest rates on mortgage loans and other long-term credit to households and businesses relative to what they otherwise would have been. But the Committee had not set specific objectives for longer-term interest rates, and participants did not consider it appropriate to allow the Desk discretion to adjust the size and composition of the Federal Reserve's asset purchases in response to short-run fluctuations in market interest rates. Some participants noted that, in principle, the Committee could formulate a plan for asset purchases that would respond to economic and financial developments in a way that might better promote monetary policy objectives. Most, however, thought that formulating and communicating such a plan would be very difficult, potentially leading to an increase in market uncertainty regarding Federal Reserve actions and intentions. Many participants agreed, however, that it was appropriate for the Desk to make small adjustments to the size and timing of purchases aimed at fostering market liquidity and improving market functioning. Participants discussed the merits of including securities backed by adjustable-rate mortgages in MBS purchases and of tapering off purchases of securities as the asset purchase programs were being completed, but the Committee did not reach a decision on those issues at the meeting.

The staff presented policymakers with proposals for extensions, modifications, and terminations of various liquidity programs. A number of the credit and liquidity facilities that the Federal Reserve had established in the course of the financial crisis were scheduled to expire on October 30. Use of most of the liquidity facilities had declined in recent months as market conditions had improved. Still, meeting participants judged that market conditions remained fragile, and that concerns about counterparty credit risk and access to liquidity, both of which had ebbed notably in recent months, could increase again. Moreover, participants viewed the availability of the liquidity facilities as a factor that had contributed to the reduction in financial strains. If the Federal Reserve's backup liquidity facilities were terminated prematurely, such developments might put renewed pressure on some financial institutions and markets and tighten credit conditions for businesses and households. The period over year-end was seen as posing heightened risks given the usual pressures in financial markets at that time. In these circumstances, participants agreed that most facilities should be extended into early next year. However, participants also judged that improved market conditions and declining use of the facilities warranted scaling back, suspending, or tightening access to several programs, including the Term Auction Facility (TAF), the Term Securities Lending Facility (TSLF), and the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF).

Following the presentation and discussion of the staff proposal, the Board voted unanimously to extend the AMLF, the Commercial Paper Funding Facility (CPFF), the Primary Dealer

Credit Facility (PDCF), and the TSLF through February 1, 2010. The Board did not extend the Money Market Investor Funding Facility (MMIFF) beyond October 30. The extension of the TSLF required the approval of the Federal Open Market Committee (FOMC), as that facility was established under the joint authority of the Board and the FOMC. The Board and the FOMC jointly decided to suspend some TSLF auctions and to reduce the size and frequency of others. In addition, the FOMC extended the temporary reciprocal currency arrangements (swap lines) between the Federal Reserve and other central banks to February 1, 2010. The FOMC unanimously passed the following resolution to extend the temporary swap arrangements and the TSLF:

"The Federal Open Market Committee extends until February 1, 2010, its authorizations for the Federal Reserve Bank of New York to engage in temporary reciprocal currency arrangements ("swap arrangements") with foreign central banks under the conditions previously established by the Committee.

The Federal Open Market Committee extends until February 1, 2010, its authorizations for the Federal Reserve Bank of New York to provide a Term Securities Lending Facility, subject to the same collateral, interest rate, and other conditions previously established by the Committee. However, the Federal Reserve Bank of New York is directed to suspend Schedule 1 TSLF auctions, effective immediately. The Federal Reserve Bank of New York is directed to conduct Schedule 2 TSLF auctions initially on a monthly basis in amounts of $75 billion; the Reserve Bank is directed to reduce over time the amounts provided through the TSLF as market conditions warrant. The Federal Reserve Bank of New York is directed to suspend operations of the Term Securities Lending Facility Options Program (TOP), effective immediately. Should market conditions appear to warrant the resumption of Schedule 1 TSLF or TOP auctions, the Account Manager is to consult with the Chairman and, if possible, the Board and the Federal Open Market Committee."

Board members and FOMC participants noted their expectation that a number of these facilities may not need to be extended beyond February 1, 2010, if the recent improvements in market conditions continue. However, if financial stresses do not moderate as expected, the Board and the FOMC were prepared to extend the terms of some or all of the facilities as needed to promote financial stability and economic growth.

Staff Review of the Economic Situation

The information reviewed at the June 23–24 meeting suggested that the economy remained very weak, though declines in activity seemed to be lessening. Employment was still falling, and manufacturers had cut production further in response to excess inventories and soft demand. But the reductions in employment and industrial production had slowed somewhat, consumer spending appeared to be holding reasonably steady after shrinking in the second half of 2008, and sales and construction of single-family homes had apparently flattened out. In addition, the recent declines in capital spending were smaller than those recorded earlier in the year. Consumer price inflation was fairly quiescent in recent months, although the upturn in energy prices appeared likely to boost headline inflation in June.

The demand for labor weakened further in May, albeit less rapidly than in earlier months. Nonfarm payrolls continued to shrink, but the decline was the smallest since September. In addition, average weekly hours of production and nonsupervisory workers on private payrolls, which had dropped substantially from September to March, were essentially unchanged in April and May. Thus aggregate hours worked by this group fell at a slower pace in April and May than on average over the previous seven months. The unemployment rate, however, rose further in May, to 9.4 percent. Despite the high level of joblessness, the labor force participation rate moved up for a second consecutive month to a level close to where it was at the beginning of the recession. The four-week moving average of initial claims for unemployment insurance fell back a little, but the number of individuals receiving unemployment insurance benefits continued to increase.

Industrial production decreased in April and May but at a slower pace than in the first quarter. Manufacturing output also fell in those months, and the factory operating rate dipped further in May. In the high-tech sector, computer output fell at a pace similar to that in the first quarter, but near-term indicators of production turned somewhat less negative and global semiconductor sales climbed in April for the second consecutive month. The production of motor vehicles and parts dropped sharply in May, principally because of extended plant shutdowns at General Motors and Chrysler. The production of commercial aircraft moved up. Outside the transportation and high-tech sectors, most industries continued to cut production in both April and May, though at a slower pace than over the preceding five months.

Real personal consumption expenditures rose somewhat in the first quarter after falling in the second half of 2008, and available data suggested that spending was holding reasonably steady in the second quarter. On the basis of the latest retail sales data, real expenditures on goods other than motor vehicles appeared to have risen slightly in May and to have changed little, on net, since the turn of the year. Sales of light motor vehicles in April and May were slightly higher than the first-quarter average. Real outlays on services were reported to have picked up some in April from the average monthly gain seen over the first three months of the year. The fundamental determinants of consumer demand appeared to have improved a bit: Despite the ongoing decline in employment, real disposable personal income rose in the first quarter and posted another sizable gain in April as various provisions of the American Recovery and Reinvestment Act of 2009 boosted transfer payments and reduced personal taxes. In addition, equity prices recorded substantial gains in April and May, reversing a small portion of the prior wealth declines. Measures of consumer sentiment, while remaining at levels typically seen during recessions, improved markedly from the historical lows recorded around the turn of the year.

Single-family housing starts edged up in May, and adjusted permit issuance for single-family houses was a little above the level of starts, as it had been since January. In contrast, activity in the much smaller multifamily sector fell significantly further, reflecting a sharp deterioration in the fundamentals in that sector. The steep decline in the demand for new single-family houses seemed to have abated. However, the pace of new home sales was still very low in April, and the months' supply of new homes remained quite elevated relative to sales despite a decrease in the stock of unsold new single-family homes to a level roughly one-half of its mid-2006 peak. Sales of existing single-family homes had been fairly steady from late 2008 through May.

The relative stability of the resale market over this period coincided with a heightened proportion of transactions involving bank-owned and other distressed properties. The apparent stabilization in housing demand was likely due, in part, to the improvement in housing affordability that resulted from low mortgage rates and declining house prices. Rates for conforming 30-year fixed-rate mortgages rose on net between late April and late June but remained below the levels seen over most of 2008. Although the market for private-label nonprime mortgages remained closed, spreads between rates for jumbo and standard conforming loans narrowed substantially since March. Meanwhile, national house prices continued to decline.

Real investment in equipment and software (E&S) continued to contract; however, the decline in the second quarter appeared likely to be smaller than in either of the two preceding quarters. Outlays on transportation equipment seemed to be firming after shrinking for an extended period, and the incoming data on shipments and orders of nondefense capital goods pointed to a moderation in the rate of decrease in other major components of E&S. The contraction in spending on computing equipment appeared to be leveling off, although businesses continued to cut their real outlays on software. Real spending on equipment outside of high-tech and transportation seemed to have dropped less rapidly in the second quarter than in the first quarter. Data suggested a substantial increase in outlays for nonresidential construction in March and April, concentrated in energy-related sectors. Outside of the energy-related sectors, demand for nonresidential building remained extremely weak and financing difficult to obtain. Although the months' supply of nonfarm business inventories remained elevated, large production cutbacks in recent quarters allowed producers to stem the rise in stocks relative to sales. The principal determinants of investment were still weak: Business output dropped further in the first quarter, the user cost of capital was higher than it was a year earlier, and credit remained tight. However, corporate bond yields eased considerably in the weeks leading to the June meeting, and monthly surveys of business conditions and sentiment were generally less downbeat than earlier in the year.

The U.S. international trade deficit widened slightly in April, as a decrease in imports was more than offset by a drop in exports. Most major categories of exports fell, with exports of machinery, industrial supplies, and consumer goods exhibiting significant declines. The value of imports of goods and services also edged down after remaining about unchanged in March. Imports of machinery and industrial supplies displayed significant decreases, and imports of services fell moderately. Imports of consumer goods increased. The value of oil imports also rose, as higher prices outweighed lower volumes.

The decline in output in the advanced foreign economies deepened in the first quarter. Domestic demand fell in all major economies, led by double-digit declines in fixed investment and sizable negative contributions of inventories to growth. Recent indicators, however, suggested that the pace of contraction likely moderated in the second quarter. Purchasing managers indexes rebounded from the exceptionally low levels reached in the first quarter, and industrial production stabilized somewhat. In emerging market economies, incoming data showed that first-quarter real gross domestic product (GDP) contracted sharply in Mexico, Hong Kong, Malaysia, and Singapore, edged up in Korea, and expanded considerably in India and Indonesia. For the second quarter, indicators suggested a broader stabilization of activity in emerging market economies. In China, retail sales and fixed-asset investment rose strongly. Financial conditions continued to improve in most emerging market economies.

In the United States, headline consumer prices were little changed between March and May, held down by declines in the prices of food and energy over that period. Core inflation was slightly higher from March to May than during the preceding three months, although core prices posted fairly small increases apart from a tax-induced jump in tobacco prices. Near-term inflation expectations in the Reuters/University of Michigan Surveys of Consumers remained steady in May and then rose somewhat in the preliminary June survey. Survey measures of long-term inflation expectations showed no signs of moving lower despite the considerable margin of labor- and product-market slack present in the economy. At earlier stages of processing, the producer price index for core intermediate materials continued to decline through May, albeit at a slower pace than that seen at the end of 2008. Spot commodity prices, which had moved higher over the first four months of 2009, rose more rapidly since the end of April. Nevertheless, these prices remained well below their year-earlier levels. The incoming data on labor costs were mixed. Although the rise in hourly compensation in the nonfarm business sector picked up slightly in the first quarter, the employment cost index decelerated further. Increases in average hourly earnings also slowed further in April and May.

Staff Review of the Financial Situation

The decision by the FOMC at its April 28–29 meeting to leave the target range for the federal funds rate unchanged and the accompanying statement indicating that the FOMC would maintain the size of the large-scale asset purchase program were largely anticipated, but yields on Treasury securities rose slightly, as a few investors apparently had seen some chance that the Committee would expand the purchase program. The release of the April FOMC minutes three weeks later prompted a reversal of this move, as market participants reportedly focused on the suggestion that the total size of the purchase program might need to be increased at some point to spur a more rapid pace of recovery. The expected path of the federal funds rate implied by futures prices was largely unchanged by the release of the Committee's statement and minutes. However, in the days following the release of the May employment report, which was read as being significantly less negative than anticipated, market participants marked up their expected path for the federal funds rate. Yields on nominal Treasury coupon securities increased, on net, over the intermeeting period. These moves likely reflected a number of factors, including investors' perceptions of an improvement in the economic outlook, decreased concerns about the risk of deflation, a reversal of flight-to-quality flows, and selling of long-duration assets as exposure to mortgage prepayment risk dropped with a rise in mortgage rates. In addition, inflation compensation rose over the intermeeting period as yields on inflation-indexed Treasury securities increased much less than those on their nominal counterparts. Some of the rise in inflation compensation may have reflected an increase in inflation expectations, but an improvement in liquidity in the market for Treasury inflation-protected securities and mortgage-related hedging flows may have boosted inflation compensation as well.

Pressures in short-term bank funding markets eased further, as evidenced by declines in London interbank offered rate (Libor) fixings and in spreads between one- and three-month Libor and comparable-maturity overnight index swap (OIS) rates. These spreads narrowed to levels not seen since early 2008, transaction volume rose modestly, and tentative signs of increased liquidity reportedly emerged. The market for repurchase agreements saw slight improvement, with bid-asked spreads for most types of transactions narrowing a bit and haircuts roughly unchanged. Spreads on A2/P2-rated commercial paper and AA-rated asset-backed commercial paper were little changed, on net, since late April, remaining at the low end of their ranges over the previous 18 months.

Over the intermeeting period, functioning in the market for Treasury securities generally improved and trading picked up, but some strains remained. The on-the-run/off-the-run premium narrowed considerably at the short end of the yield curve. Such spreads, however, remained somewhat wide for longer-dated issues, apparently reflecting concerns about volatility linked to mortgage-related hedging flows. Some strains, perhaps associated with these flows, emerged at times in the MBS market; market participants reacted to the large and rapid changes in MBS yields by widening bid-asked spreads on these securities.

Broad stock price indexes rose, on net, over the intermeeting period, reflecting generally better-than-expected economic news and further declines in risk premiums. The spread between an estimate of the expected real equity return over the next 10 years for S&P 500 firms and an estimate of the real 10-year Treasury yield—a rough gauge of the equity risk premium—narrowed noticeably but remained high by historical standards. Option-implied volatility on the S&P 500 index declined but remained elevated.

Yields on speculative-grade and investment-grade corporate bonds dropped, and spreads over yields on comparable-maturity Treasury securities narrowed considerably. Estimates of bid-asked spreads in the secondary market for speculative-grade corporate bonds fell significantly to about their average levels in the few years before the summer of 2007, while estimates of such spreads for investment-grade corporate bonds remained somewhat elevated. Market sentiment toward the syndicated leveraged loan market also improved, with the average bid price increasing noticeably and bid-asked spreads narrowing a bit further. The inclusion of commercial mortgage-backed securities (CMBS) in the Term Asset-Backed Securities Loan Facility (TALF) program resulted initially in a narrowing of commercial mortgage credit default swap (CDS) spreads; however, spreads later widened as rating agencies issued conflicting opinions regarding the credit quality of senior CMBS tranches.

Market sentiment toward the financial sector improved over the intermeeting period, reflecting, in part, the release of the Supervisory Capital Assessment Program (SCAP) results for the nation's 19 largest bank holding companies (BHCs) on May 7. Nearly all the BHCs evaluated had enough Tier 1 capital to absorb the higher losses envisioned under the hypothetical more adverse scenario; however, 10 institutions were required to enhance their capital structure to put greater emphasis on common equity. Following the announcement of the SCAP results, the 19 evaluated institutions raised, or announced plans to raise, around $70 billion in common equity through public offerings, conversion of preferred stock, and asset sales. These offerings accounted for most of the record-high total financial equity issuance in May. The evaluated BHCs have also issued additional debt under the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program (TLGP), as well as nonguaranteed debt. On June 9, the Treasury announced that 10 large financial institutions were eligible to repay the $68 billion in capital that they had received through the Troubled Asset Relief Program (TARP). CDS spreads for banking organizations declined considerably over the intermeeting period, although they remained well above historical norms. Stock price indexes for the banking sector and the broader financial sectors rose significantly.

The level of private-sector debt was estimated to have remained about unchanged in the second quarter, as a further modest decline in household debt about offset a slight increase in nonfinancial business debt. Gross bond issuance by nonfinancial corporations was robust in May. Investment-grade issuance rebounded after a lull in April. Speculative-grade issuance was the highest since June 2007, but issuance of lower-rated speculative-grade bonds remained minimal. Meanwhile, the federal government issued large amounts of debt, and state and local government debt was estimated to have expanded moderately.

The expansion of M2 slowed significantly in April and May, as the reallocation of household wealth toward the safety and liquidity of M2 assets evidently moderated. Retail money market mutual funds and small time deposits contracted in both months, probably in response to declining interest rates on these assets. The rise in currency diminished, likely reflecting primarily a waning in foreign demand.

Commercial bank credit increased slightly in May following six consecutive monthly declines, but the turnaround reflected a rise in securities holdings and in the volatile "other" loans category—that is, loans other than commercial and industrial (C&I), real estate, and consumer loans. C&I loans dropped in May, amid subdued origination activity and broad-based paydowns of outstanding loans. Home equity loans edged down—the first monthly decline in this category since October 2006—partly because of banks' reductions in existing lines of credit. Closed-end residential mortgages decreased; originations were reportedly strong but were more than offset by loan sales to the government-sponsored enterprises. The amount of outstanding consumer loans originated by banks shrank during April and May; the quantity of consumer loans on banks' balance sheets decreased even more because of a number of large credit card securitizations.

The dollar depreciated substantially during the intermeeting period against all other major currencies. This decline appeared to be driven by a renewed sense of optimism about global growth prospects, leading investors to shift away from safe-haven assets in the United States to riskier assets elsewhere. Libor-to-OIS spreads in euros and sterling decreased, and several foreign banks took advantage of improved financial conditions to raise capital and increase issuance of debt outside of government guarantee programs. The improved access to capital markets and better economic outlook buoyed bank stocks, which helped headline equity indexes move higher. Most stock markets in emerging market economies rose considerably, and mutual fund flows into those markets strengthened.

The European Central Bank lowered its main policy rate 25 basis points to 1 percent and announced that it would purchase up to €60 billion in covered bonds. The Bank of England, the Bank of Canada, and the Bank of Japan kept their policy rates constant over the intermeeting period, but the Bank of England increased the size of its planned asset purchases from £75 billion to £125 billion. The Bank of Japan continued purchasing commercial paper, corporate bonds, equities, and government bonds. Chinese authorities held the renminbi nearly unchanged against the dollar, and several central banks intervened to purchase dollars, attempting to slow the dollar's depreciation against their currencies.

Staff Economic Outlook

In the forecast prepared for the June meeting, the staff revised upward its outlook for economic activity during the remainder of 2009 and for 2010. Consumer spending appeared to have stabilized since the start of the year, sales and starts of new homes were flattening out, and the recent declines in capital spending did not look as severe as those that had occurred around the turn of the year. Recent declines in payroll employment and industrial production, while still sizable, were smaller than those registered earlier in 2009. Household wealth was higher, corporate bond rates had fallen, the value of the dollar was lower, the outlook for foreign activity was better, and financial stress appeared to have eased somewhat more than had been anticipated in the staff forecast prepared for the prior FOMC meeting. The projected boost to aggregate demand from these factors more than offset the negative effects of higher oil prices and mortgage rates. The staff projected that real GDP would decline at a substantially slower rate in the second quarter than it had in the first quarter and then increase in the second half of 2009, though less rapidly than potential output. The staff also revised up its projection for the increase in real GDP in 2010, to a pace above the growth rate of potential GDP. As a consequence, the staff projected that the unemployment rate would rise further in 2009 but would edge down in 2010. Meanwhile, the staff forecast for inflation was marked up. Recent readings on core consumer prices had come in a bit higher than expected; in addition, the rise in energy prices, less-favorable import prices, and the absence of any downward movement in inflation expectations led the staff to raise its medium-term inflation outlook. Nonetheless, the low level of resource utilization was projected to result in an appreciable deceleration in core consumer prices through 2010.

Looking ahead to 2011 and 2012, the staff anticipated that financial markets and institutions would continue to recuperate, monetary policy would remain stimulative, fiscal stimulus would be fading, and inflation expectations would be relatively well anchored. Under such conditions, the staff projected that real GDP would expand at a rate well above that of its potential, that the unemployment rate would decline significantly, and that overall and core personal consumption expenditures inflation would stay low.

Participants' Views and Committee Policy Action

In conjunction with this FOMC meeting, all meeting participants—the five members of the Board of Governors and the presidents of the 12 Federal Reserve Banks—provided projections for economic growth, the unemployment rate, and consumer price inflation for each year from 2009 through 2011 and over a longer horizon. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks. Participants' forecasts through 2011 and over the longer run are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In their discussion of the economic situation and outlook, participants generally agreed that the information received since the April meeting indicated that the economic contraction was slowing and that the decline in activity could cease before long. Business and household confidence had picked up some, and survey data and anecdotal reports showed improved expectations for the future. The inventory adjustment process was continuing, housing and consumption demand apparently had leveled off, and financial market strains had eased further. Nonetheless, most participants saw the economy as still quite weak and vulnerable to further adverse shocks. Conditions in the labor market remained poor, and the unemployment rate continued to rise. These factors, along with past declines in wealth, would weigh on consumer spending. Although financial market conditions had improved, credit was still quite tight in many sectors. Economic activity in foreign economies was unlikely to be sufficiently strong to provide a substantial boost to U.S. exports. Against this backdrop, participants generally judged that, while U.S. output would probably begin to grow again in the second half of the year, the rate of increase was likely to be relatively slow. Most believed that downside risks to economic growth had diminished somewhat since the April meeting, but were still significant.

Developments in financial markets over the intermeeting period were seen as broadly positive, reflecting, at least in part, a reduction in the perceived risk of further severely adverse outcomes. In particular, many participants noted that the results of the SCAP helped bolster confidence in banks and led to large infusions of private capital in that sector. Corporate credit markets continued to improve, and markets for asset-backed securities also showed an increasing amount of activity, supported in part by the TALF. Increases in equity prices had favorable effects on household wealth and overall sentiment. Still, participants generally noted that the improvement in market conditions was in part due to ongoing support from various government programs and that underlying financial conditions remained fragile. Credit was tight, with some banks quite reluctant to lend. Worsening credit quality, especially for consumer and commercial real estate loans, was seen as an important reason for reduced lending and tighter terms, and banks could face substantial losses in their loan portfolios in coming quarters. Many participants noted that obtaining financing for commercial real estate projects remained extremely difficult amid worsening fundamentals in the sector.

Consumer spending appeared no longer to be declining but nonetheless remained weak. The continued sluggishness in consumer expenditures mainly reflected falling employment, sharply lower wealth as a result of earlier steep declines in asset prices, and tight credit conditions. Because these factors were not seen as likely to dissipate quickly, most participants judged that consumer spending would continue to be subdued for some time. Given the significant uncertainties in the economic outlook, a sizable reduction in the saving rate seemed unlikely in the near term; some saw the possibility of further increases in the household saving rate. Participants also observed that, while personal income had expanded briskly of late, those increases had been boosted by special one-time factors such as fiscal stimulus and large cost-of-living adjustments for Social Security recipients. Personal income was likely to contract for a time going forward as the effects of these factors waned, and there was some risk that consumer spending might also decline as a consequence.

Indicators of single-family starts and sales suggested that housing activity may be leveling out, but most participants viewed the sector as still vulnerable to further weakness. Some expressed concern that the increases in mortgage rates seen over the intermeeting period had the potential to further depress the demand for housing and thus impede an economic recovery. Others noted that foreclosures were continuing at a very high rate and could push house prices down further and add to inventories of unsold homes, holding back housing activity and weighing on household wealth.

Labor market conditions were of particular concern to meeting participants. Although some improvements were evident in new and continuing unemployment insurance claims and the May payroll report was less weak than expected, job losses remained substantial over the intermeeting period and the unemployment rate continued to rise rapidly. Rising labor force participation contributed to the increase in the unemployment rate. Some participants pointed out that households' financial strains may be encouraging many individuals to enter the labor market despite difficult labor market conditions. Reports from district contacts suggested that workweeks were being trimmed and that total hours worked were falling significantly. The large number of people working part time for economic reasons and the prevalence of permanent job reductions rather than temporary layoffs suggested that labor market conditions were even more difficult than indicated by the unemployment rate. With the recovery projected to be rather sluggish, most participants anticipated that the employment situation was likely to be downbeat for some time.

Anecdotal reports suggested that the weakness in activity was widespread across many industries and extended to the service sector. However, some meeting participants highlighted evidence from regional surveys that pointed to a stabilization or even a slight pickup in manufacturing in some areas, and positive signs were apparent in the energy and agriculture sectors. Participants noted an improvement in business sentiment in many districts, but contacts remained quite uncertain about the timing and extent of the recovery; elevated uncertainty was said to be inhibiting capital spending in many cases. Many businesses had been successful in working down inventories of unsold goods. Some participants noted that, as this process continues, increases in sales will have to be met by increases in production, which would, in turn, support growth in hours worked and eventually in investment outlays.

Many participants noted that the global nature of this recession meant that growth abroad was not likely to bolster U.S. exports and so contribute to a recovery in the United States. In Europe, for example, unemployment was also rising sharply and financial strains remained significant. Some participants thought that recovery there was likely to lag behind that of the United States. In Asia, the outlook appeared more promising, with some evidence that the rate of decline in activity was diminishing. Recent information from China suggested that economic growth may be picking up there. Still, some participants mentioned that growth in that region was likely to remain importantly dependent on exports to major industrial economies that were likely to recover slowly.

Although recent increases in oil and other commodity prices were likely to raise headline inflation over the near term, most participants expected core inflation to remain subdued for some time. Several measures of labor compensation had slowed in recent quarters as unemployment mounted and wages were not likely to exert any significant upward pressures on prices, given the expectation that labor market conditions were likely to deteriorate further in coming months and probably would not improve quickly thereafter. In addition, many participants noted that productivity growth had been surprisingly strong in recent quarters. Although the measured increase in productivity might reflect cyclical factors rather than changes in the underlying trend and was subject to data revisions, growth in unit labor costs was expected to continue to be restrained in coming quarters. Substantial resource slack was also likely to keep price inflation low in the future. Participants noted the considerable uncertainty surrounding estimates of the output and unemployment gaps and the extent of their effects on prices. However, most agreed that, even taking account of such uncertainty, the economy was almost certainly operating well below its potential and that significant price pressures were unlikely to materialize in the near and medium terms. Still, in light of the signs that economic activity was stabilizing, most participants saw less downside risk to their expectations for inflation. Moreover, participants pointed out that some measures of inflation expectations had edged up recently from very low readings, perhaps reflecting in part reduced concerns about deflation, and were now at levels close to those prevailing prior to the onset of the crisis. A few participants were concerned that inflation expectations could continue to rise, especially in light of the Federal Reserve's greatly expanded balance sheet and the associated large volume of reserves in the banking system, and that as a result inflation could temporarily rise above levels consistent with the Committee's dual objectives of maximum employment and stable prices. Most participants, however, expected that inflation would remain subdued for some time.

In their discussion of monetary policy for the period ahead, Committee members agreed that the stance of monetary policy should not be changed at this meeting. Given the prospects for weak economic activity, substantial resource slack, and subdued inflation, the Committee agreed that it should maintain its target range for the federal funds rate at 0 to ¼ percent. The future path of the federal funds rate would depend on the Committee's evolving expectations for the economy, but for now, members thought it most likely that the federal funds rate would need to be maintained at an exceptionally low level for an extended period, given their forecasts for only a gradual upturn in activity and the lack of inflation pressures. The Committee also agreed that changes to its program of asset purchases were not warranted at this time. Although an expansion of such purchases might provide additional support to the economy, the effects of further asset purchases, especially purchases of Treasury securities, on the economy and on inflation expectations were uncertain. Moreover, it seemed likely that economic activity was in the process of leveling out, and the considerable improvements in financial markets over recent months were likely to lend further support to aggregate demand. Accordingly, the Committee agreed that the asset purchase programs should proceed for now on the schedule announced at previous meetings.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase agency debt, agency MBS, and longer-term Treasury securities during the intermeeting period with the aim of providing support to private credit markets and economic activity. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of private credit market conditions. The Committee anticipates that the combination of outright purchases and various liquidity facilities outstanding will cause the size of the Federal Reserve's balance sheet to expand significantly in coming months. The Desk is expected to purchase up to $200 billion in housing-related agency debt by the end of this year. The Desk is expected to purchase up to $1.25 trillion of agency MBS by the end of the year. The Desk is expected to purchase up to $300 billion of longer-term Treasury securities by the end of the third quarter. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in April suggests that the pace of economic contraction is slowing. Conditions in financial markets have generally improved in recent months. Household spending has shown further signs of stabilizing but remains constrained by ongoing job losses, lower housing wealth, and tight credit. Businesses are cutting back on fixed investment and staffing but appear to be making progress in bringing inventory stocks into better alignment with sales. Although economic activity is likely to remain weak for a time, the Committee continues to anticipate that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will contribute to a gradual resumption of sustainable economic growth in a context of price stability.

The prices of energy and other commodities have risen of late. However, substantial resource slack is likely to dampen cost pressures, and the Committee expects that inflation will remain subdued for some time.

In these circumstances, the Federal Reserve will employ all available tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period. As previously announced, to provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve will purchase a total of up to $1.25 trillion of agency mortgage-backed securities and up to $200 billion of agency debt by the end of the year. In addition, the Federal Reserve will buy up to $300 billion of Treasury securities by autumn. The Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. The Federal Reserve is monitoring the size and composition of its balance sheet and will make adjustments to its credit and liquidity programs as warranted."

Voting for this action: Messrs. Bernanke and Dudley, Ms. Duke, Messrs. Evans, Kohn, Lacker, Lockhart, Tarullo, and Warsh, and Ms. Yellen.

Voting against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, August 11–12, 2009. The meeting adjourned at 12:40 p.m. on June 24, 2009.

Notation Vote

By notation vote completed on May 19, 2009, the Committee unanimously approved the minutes of the FOMC meeting held on April 28–29, 2009.

Conference Call

On June 3, 2009, the Committee met by conference call in a joint session with the Board of Governors to review recent economic and financial developments, including changes in the Federal Reserve's balance sheet. In addition, by unanimous vote, Brian Sack was selected to serve as Manager, System Open Market Account, on the understanding that his selection was subject to being satisfactory to the Federal Reserve Bank of New York.

Secretary's note: Advice subsequently was received that the selection of Mr. Sack as Manager was satisfactory to the Board of Directors of the Federal Reserve Bank of New York.

Brian F. Madigan
Secretary

Addendum: Summary of Economic Projections

In conjunction with the June 23–24, 2009, FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in deliberations of the FOMC, submitted projections for output growth, unemployment, and inflation in 2009, 2010, 2011, and over the longer run. Projections were based on information available through the end of the meeting and on each participant's assumptions about factors likely to affect economic outcomes, including his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future path of policy that the participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her interpretation of the Federal Reserve's dual objectives of maximum employment and stable prices. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

FOMC participants generally expected that, after declining over the first half of this year, output would expand sluggishly over the remainder of the year. Consequently, as indicated in table 1 and depicted in figure 1, all FOMC participants projected that real gross domestic product (GDP) would

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, June 2009
Percent

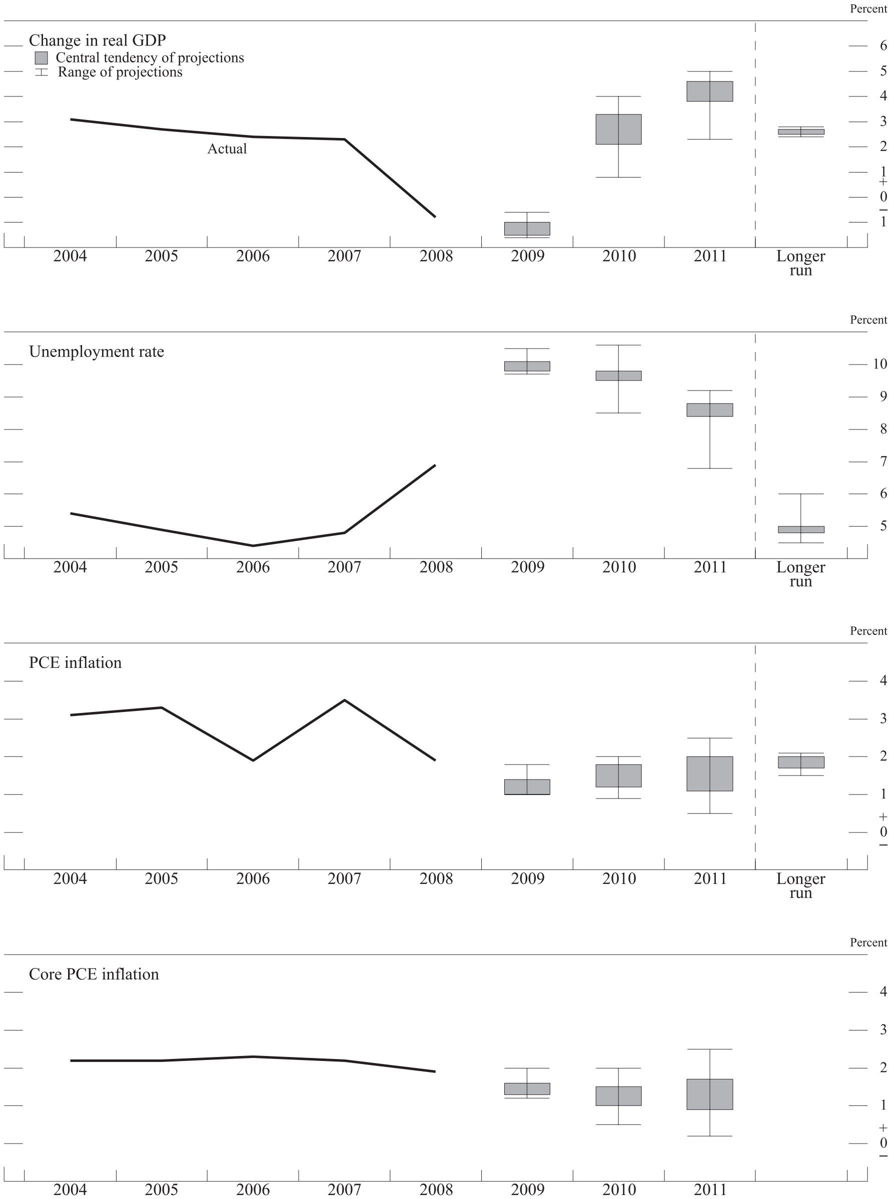
Variable	Central tendency[1]				Range[2]			
	2009	2010	2011	Longer Run	2009	2010	2011	Longer Run
Change in real GDP . .	−1.5 to −1.0	2.1 to 3.3	3.8 to 4.6	2.5 to 2.7	−1.6 to −0.6	0.8 to 4.0	2.3 to 5.0	2.4 to 2.8
April projection . . .	−2.0 to −1.3	2.0 to 3.0	3.5 to 4.8	2.5 to 2.7	−2.5 to −0.5	1.5 to 4.0	2.3 to 5.0	2.4 to 3.0
Unemployment rate . .	9.8 to 10.1	9.5 to 9.8	8.4 to 8.8	4.8 to 5.0	9.7 to 10.5	8.5 to 10.6	6.8 to 9.2	4.5 to 6.0
April projection . . .	9.2 to 9.6	9.0 to 9.5	7.7 to 8.5	4.8 to 5.0	9.1 to 10.0	8.0 to 9.6	6.5 to 9.0	4.5 to 5.3
PCE inflation	1.0 to 1.4	1.2 to 1.8	1.1 to 2.0	1.7 to 2.0	1.0 to 1.8	0.9 to 2.0	0.5 to 2.5	1.5 to 2.1
April projection . . .	0.6 to 0.9	1.0 to 1.6	1.0 to 1.9	1.7 to 2.0	−0.5 to 1.2	0.7 to 2.0	0.5 to 2.5	1.5 to 2.0
Core PCE inflation[3] .	1.3 to 1.6	1.0 to 1.5	0.9 to 1.7		1.2 to 2.0	0.5 to 2.0	0.2 to 2.5	
April projection . . .	1.0 to 1.5	0.7 to 1.3	0.8 to 1.6		0.7 to 1.6	0.5 to 2.0	0.2 to 2.5	

NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The April projections were made in conjunction with the meeting of the Federal Open Market Committee on April 28–29, 2009.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.
2. The range for a variable in a given year includes all participants' projections, from lowest to highest, for that variable in that year.
3. Longer-run projections for core PCE inflation are not collected.

contract over the entirety of this year and that the unemployment rate would increase in coming quarters. All participants also expected that overall inflation would be somewhat slower this year than in recent years, and most projected that core inflation would edge down this year. Almost all participants viewed the near-term outlook for domestic output as having improved modestly relative to the projections they made at the time of the April FOMC meeting, reflecting both a slightly less severe contraction in the first half of 2009 and a moderately stronger, but still sluggish, recovery in the second half. With the strong adverse forces that have been acting on the economy likely to abate only slowly, participants generally expected the recovery to be gradual in 2010. Even though all participants had raised their near-term outlook for real GDP, in light of incoming data on labor markets, they increased their projections for the path of the unemployment rate from those published in April. Participants foresaw only a gradual improvement in labor market conditions in 2010 and 2011, leaving the unemployment rate at the end of 2011 well above the level they viewed as its longer-run sustainable rate. Participants projected low inflation this year. For 2010 and 2011, the central tendencies of the participants' inflation forecasts pointed to fairly stable inflation that would be modestly below most participants' estimates of the rate consistent with the dual objectives; however, the divergence of participants' views about the inflation outlook remained wide. Most participants indicated that they expected the economy to take five or six years to converge to a longer-run path characterized by a sustainable rate of output growth and by rates of unemployment and inflation consistent with the Federal Reserve's dual objectives, but several said full convergence would

Figure 1. Central tendencies and ranges of economic projections, 2009–11 and over the longer run



NOTE: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual.

take longer. In contrast to recent projections, a majority of participants perceived the risks to growth as roughly balanced, although several still viewed those risks as tilted to the downside. Most participants saw the risks surrounding their inflation outlook as roughly balanced, and fewer participants than in April characterized those risks as skewed to the downside. With few exceptions, participants judged that the projections for economic activity and inflation remained subject to a degree of uncertainty exceeding historical norms.

The Outlook

Participants' projections for the change in real GDP in 2009 had a central tendency of negative 1.5 percent to negative 1.0 percent, somewhat above the central tendency of negative 2.0 percent to negative 1.3 percent for their April projections. Participants noted that the data received between the April and June FOMC meetings pointed to a somewhat smaller decline in output during the first half of the year than they had anticipated at the time of the April meeting. Moreover, participants saw additional indications that the economic downturn in the United States and worldwide was moderating in the second quarter, and they continued to expect that sales and production would begin to recover gradually during the second half of the year, reflecting the effects of monetary and fiscal stimulus, measures to support credit markets, and diminishing financial stresses. As reasons for marking up their projections for near-term economic activity, participants pointed to a further improvement in financial conditions during the intermeeting period, signs of stabilization in consumer spending, and tentative indications of a leveling out of activity in the housing sector. In addition, they observed that aggressive inventory reductions during the first half of this year appeared to have left firms' stocks in better balance with sales, suggesting that production is likely to increase as sales stabilize and then start to turn up later this year. Participants expected, however, that recoveries in consumer spending and residential investment initially would be damped by further deterioration in labor markets, the continued repair of household balance sheets, persistently tight credit conditions, and still-weak housing demand. They also anticipated that very low capacity utilization, sluggish growth in sales, uncertainty about the economic environment, and a continued elevated cost and limited availability of financing would contribute to continued weakness in business fixed investment this year. Some participants noted that weak economic conditions in other countries probably would hold down growth in U.S. exports. A number of participants also saw recent increases in some long-term interest rates and in oil prices as factors that could damp a near-term economic recovery.

Looking further ahead, participants' projections for real GDP growth in 2010 and 2011 were not materially different from those provided in April. The projections for growth in 2010 had a central tendency of 2.1 to 3.3 percent, and those for 2011 had a central tendency of 3.8 to 4.6 percent. Participants generally expected that household financial positions would improve only gradually and that strains in credit markets and in the banking system would ebb slowly; hence, the pace of recovery would continue to be damped in 2010. But they anticipated that the upturn would strengthen in late 2010 and in 2011 to a pace exceeding the growth rate of potential GDP. Participants noted several factors contributing to this pickup, including accommodative monetary policy, fiscal stimulus, and continued improvement in financial conditions and household balance sheets. Beyond 2011, they expected that output growth would remain above that of potential GDP for a time, leading to a gradual elimination of slack in resource utilization. Over the longer run, most participants expected that, without further shocks, real GDP growth eventually would converge to a rate of 2.5 to 2.7 percent per year, reflecting longer-term trends in the growth of productivity and the labor force.

Even though participants raised their output growth forecasts, they also moved up their unemployment rate projections and continued to anticipate that labor market conditions would deteriorate further over the remainder of the year. Their projections for the average unemployment rate during the fourth quarter of 2009 had a central tendency of 9.8 to 10.1 percent, about ½ percentage point above the central tendency of their April projections and noticeably higher than the actual unemployment rate of 9.4 percent in May—the latest reading available at the time of the June FOMC meeting. All participants raised their forecasts of the unemployment rate at the end of this year, reflecting the sharper-than-expected rise in unemployment that occurred over the intermeeting period. With little material change in projected output growth in 2010 and 2011, participants still expected unemployment to decline in those years, but the projected unemployment rate in each year was about ½ percentage point above the April forecasts, reflecting the higher starting point of the projections. Most participants anticipated that output growth next year would not substantially exceed its longer-run sustainable rate and hence that the unemployment rate would decline only modestly in 2010; some also pointed to frictions associated with the reallocation of labor from shrinking economic sectors to expanding sectors as likely to restrain progress in reducing unemployment. The central tendency of the unemployment rate at the end of 2010 was 9.5 to 9.8 percent. With output growth and job creation generally projected to pick up appreciably in 2011, participants anticipated that joblessness would decline more noticeably, as evident from the central tendency of 8.4 to 8.8 percent for their projections of the unemployment rate in the fourth quarter of 2011. They expected that the unemployment rate would decline considerably further in subsequent years as it moved back toward its longer-run sustainable level, which most participants still saw as between 4.8 and 5.0 percent; however, a few participants raised their estimates of the longer-run unemployment rate.

The central tendency of participants' projections for personal consumption expenditures (PCE) inflation in 2009 was 1.0 to 1.4 percent, about ½ percentage point above the central tendency of their April projections. Participants noted that higher-than-expected inflation data over the intermeeting period and the anticipated influence of higher oil and commodity prices on consumer prices were factors contributing to the increase in their inflation forecasts. Looking beyond this year, participants' projections for total PCE inflation had central tendencies of 1.2 to 1.8 percent for 2010 and 1.1 to 2.0 percent for 2011, modestly higher than the central tendencies from the April projections. Reflecting the large increases in energy prices over the intermeeting period, the forecasts for core PCE inflation (which excludes the direct effects of movements in food and energy prices) in 2009 were raised by less than the projections for total PCE inflation, while the forecasts for core and total PCE inflation in 2010 and 2011 increased by similar amounts. The central tendency of projections for core inflation in 2009 was 1.3 to 1.6 percent; those for 2010 and 2011 were 1.0 to 1.5 percent and 0.9 to 1.7 percent, respectively. Most participants expected that sizable economic slack would continue to damp inflation pressures for the next few years and hence that total PCE inflation in 2011 would still be below their assessments of its appropriate longer-run level. Some thought that such slack would generate a decline in inflation over the next few years. Most, however, projected that, as the economy recovers, inflation would increase gradually and move closer to their individual assessments of the measured rate of inflation consistent with the Federal Reserve's dual mandate for maximum employment and price stability. Several participants, noting that the public's longer-run inflation expectations had not changed appreciably, expected that inflation would return more promptly to levels consistent with their judgments about longer-run inflation than these participants had projected in April. A few participants also anticipated that projected inflation in 2011 would be modestly above their longer-run inflation projections because of the possible effects of very low short-term interest rates and of the large expansion of the Federal Reserve's balance sheet on the public's inflation expectations. Overall, the range of participants' projections of inflation in 2011 remained quite wide.

As in April, the central tendency of projections of the longer-run inflation rate was 1.7 to 2.0 percent. Most participants judged that a longer-run PCE inflation rate of 2 percent would be consistent with the Federal Reserve's dual mandate; others indicated that inflation of 1½ percent or 1¾ percent would be appropriate. Modestly positive longer-run inflation would allow the Committee to stimulate economic activity and support employment by setting the federal funds rate temporarily below the inflation rate when the economy suffers a large negative shock to demands for goods and services.

Uncertainty and Risks

In contrast to the participants' views over the past several quarters, in June a majority of participants saw the risks to their projections for real GDP growth and the unemployment rate as broadly balanced. In explaining why they perceived a reduction in downside risks to the outlook, these participants pointed to the tentative signs of economic stabilization, indications of some effectiveness of monetary and fiscal policy actions, and improvements in financial conditions. In contrast, several participants still saw the risks to their GDP growth forecasts as skewed to the downside and the associated risks to unemployment as skewed to the upside. Almost all participants shared the judgment that their projections of future economic activity and unemployment continued to be subject to greater-than-average uncertainty.[11] Many partici-

11. Table 2 provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1989 to 2008. At the end of this summary, the box titled "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risks attending participants' projections.

Table 2. Average historical projection error ranges
Percentage points

Variable	2009	2010	2011
Change in real GDP[1] ...	±1.0	±1.5	±1.6
Unemployment rate[1]	±0.4	±0.8	±1.0
Total consumer prices[2] ..	±0.9	±1.0	±1.0

NOTE: Error ranges shown are measured as plus or minus the root mean squared error of projections that were released in the winter from 1989 through 2008 for the current and following two years by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1. For definitions, refer to general note in table 1.

2. Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

pants again highlighted the still-considerable uncertainty about the future course of the financial crisis and the risk that a resurgence of financial turmoil could adversely impact the real economy. In addition, some noted the difficulty in gauging the macroeconomic effects of the credit-easing policies that have been employed by the Federal Reserve and other central banks, given the limited experience with such tools.

Most participants judged the risks to the inflation outlook as roughly balanced, with the number doing so higher than in April. A few participants continued to view these risks as skewed to the downside, and one saw the inflation risks as tilted to the upside. Some participants noted the risk that inflation expectations might drift downward in response to persistently low inflation outcomes and continued significant slack in resource utilization. Several participants pointed to the possibility of an upward shift in expected and actual inflation if the stimulative monetary policy measures and the attendant expansion of the Federal Reserve's balance sheet were not unwound in a timely fashion as the economy recovers. Most participants again saw the uncertainty surrounding their inflation projections as exceeding historical norms.

Diversity of Views

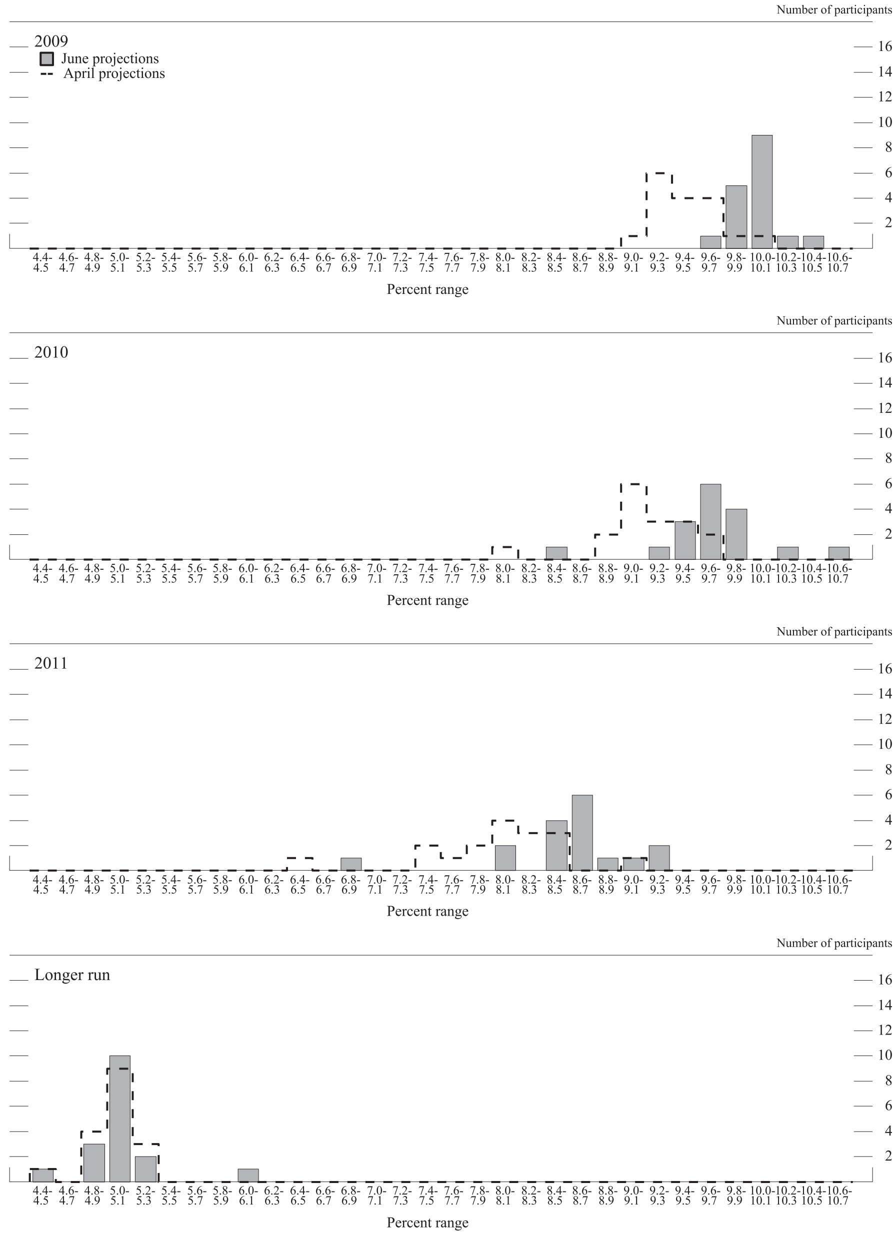
Figures 2.A and 2.B provide further details on the diversity of participants' views regarding likely outcomes for real GDP growth and the unemployment rate in 2009, 2010, 2011, and over the longer run. The dispersion in participants' June projections for the next three years reflects, among other factors, the diversity of their assessments regarding the effects of fiscal stimulus and nontraditional monetary policy actions as well as the likely pace of improvement in financial conditions. For real GDP growth, the distribution of projections for 2009 narrowed and shifted slightly higher, reflecting the somewhat better-than-expected data received during the intermeeting period. The distributions for 2010 and 2011 changed little. For the unemployment rate, the surprisingly large increases in unemployment reported during the intermeeting period prompted an upward shift in the distribution. Because of the persistence exhibited in many of the unemployment forecasts, there were similar upward shifts in the distributions for 2010 and 2011. The dispersion of these forecasts for all three years was roughly similar to that of April. The distribution of participants' projections of longer-run real GDP growth was about unchanged. A few participants raised their longer-run projections of the unemployment rate, widening the dispersion of these estimates, as they incorporated the effects of unexpectedly high recent unemployment data and of the reallocation of labor from declining sectors to expanding ones. The dispersion in participants' longer-run projections reflected differences in their estimates regarding the sustainable rates of output growth and unemployment to which the economy would converge under appropriate monetary policy and in the absence of any further shocks.

Figures 2.C and 2.D provide corresponding information about the diversity of participants' views regarding the inflation outlook. The distribution of the projections for total and core PCE inflation in 2009 moved upward, reflecting the higher inflation data released over the intermeeting period, while distributions for the projections in 2010 and 2011 did not change significantly. The dispersion in participants' projections for total and core PCE inflation for 2009, 2010, and 2011 illustrates their varying assessments of the effects on inflation and inflation expectations of persistent economic slack as well as of the recent expansion of the Federal Reserve's balance sheet. These varying assessments are especially evident in the wide dispersion of inflation projections for 2011. In contrast, the tight distribution of participants' projections for longer-run inflation illustrates their substantial agreement about the measured rate of inflation that is most consistent with the Federal Reserve's dual objectives of maximum employment and stable prices.

Figure 2.A. Distribution of participants' projections for the change in real GDP, 2009–11 and over the longer run

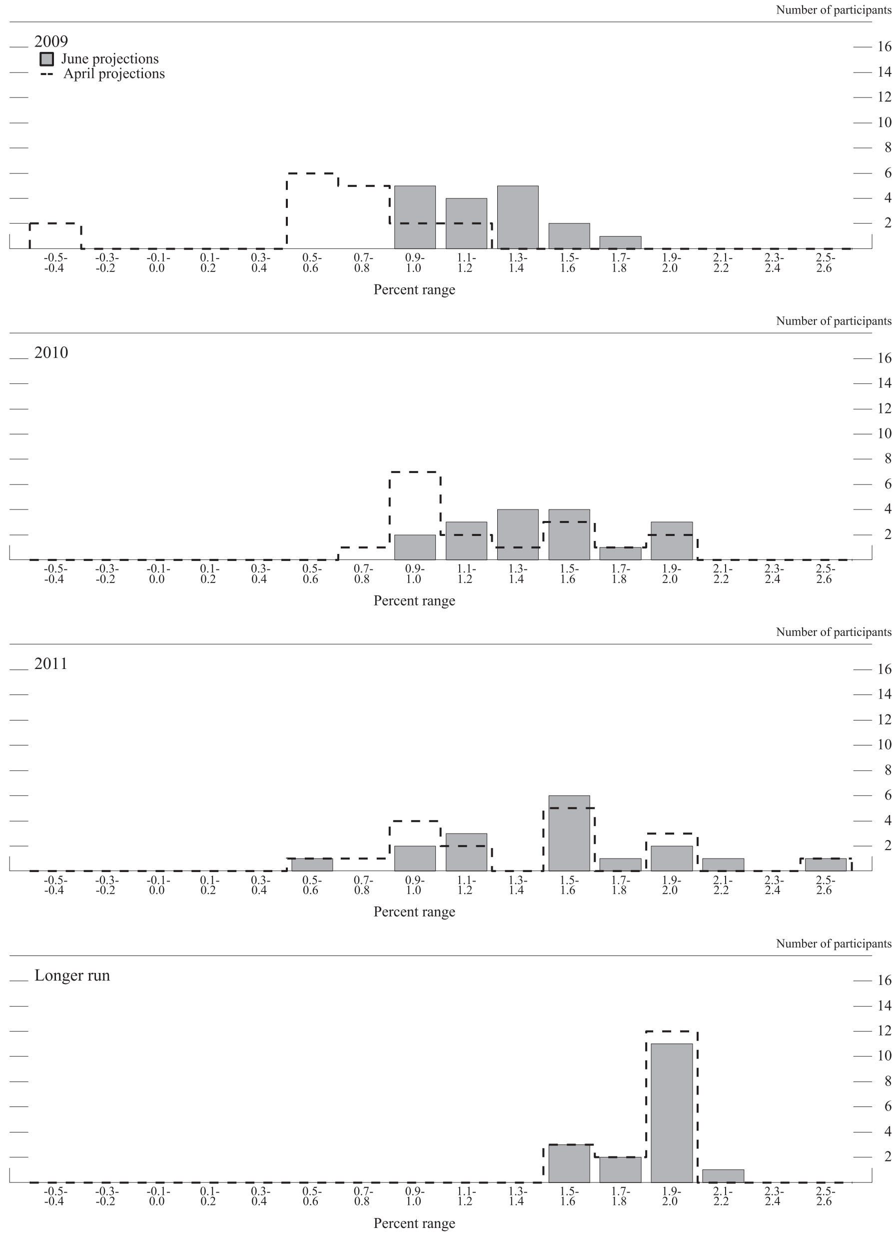
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of participants' projections for the unemployment rate, 2009–11 and over the longer run



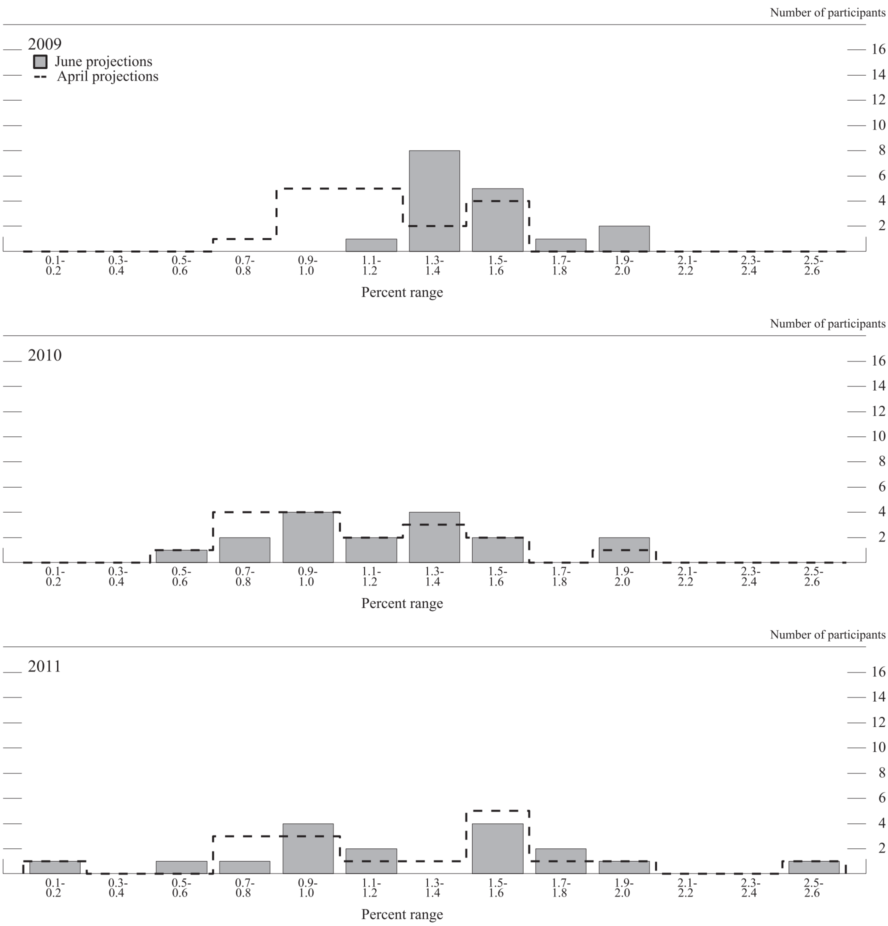
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of participants' projections for PCE inflation, 2009–11 and over the longer run



NOTE: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of participants' projections for core PCE inflation, 2009–11



NOTE: Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 2.0 to 4.0 percent in the current year, 1.5 to 4.5 percent in the second year, and 1.4 to 4.6 percent in the third year. The corresponding 70 percent confidence intervals for overall inflation would be 1.1 to 2.9 percent in the current year and 1.0 to 3.0 percent in the second and third years.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

Meeting Held on August 11–12, 2009

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, August 11, 2009, at 2:00 p.m. and continued on Wednesday, August 12, 2009, at 9:00 a.m.

Present:

Mr. Bernanke, Chairman
Mr. Dudley, Vice Chairman
Ms. Duke
Mr. Evans
Mr. Kohn
Mr. Lacker
Mr. Lockhart
Mr. Tarullo
Mr. Warsh
Ms. Yellen

Mr. Bullard, Ms. Cumming, Mr. Hoenig, Ms. Pianalto, and Mr. Rosengren, Alternate Members of the Federal Open Market Committee

Messrs. Fisher, Plosser, and Stern, Presidents of the Federal Reserve Banks of Dallas, Philadelphia, and Minneapolis, respectively

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Mr. Luecke, Assistant Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter,[12] Deputy General Counsel
Mr. Sheets, Economist
Mr. Stockton, Economist

Messrs. Altig, Clouse, Connors, Slifman, Sullivan, and Wilcox, Associate Economists

Mr. Sack, Manager, System Open Market Account

Ms. Johnson, Secretary of the Board, Office of the Secretary, Board of Governors

Ms. George, Acting Director, Division of Banking Supervision and Regulation, Board of Governors

Mr. Frierson,[12] Deputy Secretary, Office of the Secretary, Board of Governors

Mr. Struckmeyer, Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

Mr. English, Deputy Director, Division of Monetary Affairs, Board of Governors

Ms. Robertson, Assistant to the Board, Office of Board Members, Board of Governors

Ms. Liang, Messrs. Reifschneider and Wascher, Senior Associate Directors, Division of Research and Statistics, Board of Governors

Mr. Meyer, Senior Adviser, Division of Monetary Affairs, Board of Governors

Messrs. Leahy and Nelson,[12] Associate Directors, Divisions of International Finance and Monetary Affairs, respectively, Board of Governors

Mr. Carpenter, Deputy Associate Director, Division of Monetary Affairs, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Ms. Wei, Economist, Division of Monetary Affairs, Board of Governors

Ms. Beattie,[12] Assistant to the Secretary, Office of the Secretary, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Mr. Lyon, First Vice President, Federal Reserve Bank of Minneapolis

12. Attended Tuesday's session only.

Mr. Sniderman, Executive Vice President, Federal Reserve Bank of Cleveland

Mr. McAndrews,[12] Ms. McLaughlin, Messrs. Rudebusch, Sellon, Tootell, and Waller, Senior Vice Presidents, Federal Reserve Banks of New York, New York, San Francisco, Kansas City, Boston, and St. Louis, respectively

Messrs. Burke, Dotsey, Koenig, and Pesenti, Vice Presidents, Federal Reserve Banks of New York, Philadelphia, Dallas, and New York, respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

Mr. Hetzel, Senior Economist, Federal Reserve Bank of Richmond

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on recent developments in domestic and foreign financial markets. The Manager also reported on System open market operations in Treasury securities, agency debt, and agency mortgage-backed securities (MBS) since the Committee's June 23–24 meeting. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account during the intermeeting period. The Federal Reserve's total assets were about unchanged, on balance, since the Committee met in June, remaining at approximately $2 trillion as the System's purchases of securities were essentially matched by a further decline in usage of the System's credit and liquidity facilities.

Meeting participants again discussed the merits of including agency MBS backed by adjustable-rate mortgages (ARMs) in the Committee's MBS purchase program: Some thought it would be useful to include agency ARM MBS, noting that doing so could reduce the unusually large spreads between ARM rates and yields on similar-duration Treasury securities—spreads that were far larger than the comparable spreads on fixed-rate mortgages; others saw little potential benefit, given the small stock and limited issuance of ARM MBS, and were hesitant to involve the Federal Reserve in another market segment. The Committee made no decision on purchasing ARM MBS at this meeting. Participants also discussed the merits of progressively reducing the pace at which the Federal Reserve buys Treasury securities, agency debt, and agency MBS prior to the end of the asset purchase programs. They generally were of the view that gradually slowing the pace of the Committee's purchases of $300 billion of Treasury securities and extending their completion to the end of October could help promote a smooth transition in markets. A number of participants noted that a similar tapering of agency debt and MBS purchases could be helpful in the future as those programs approach completion. The Committee made no decisions on tapering those purchases at this meeting.

The staff presented an update on the continuing development of several tools that could help support a smooth withdrawal of policy accommodation at the appropriate time. These measures include executing reverse repurchase agreements on a large scale, potentially with counterparties other than the primary dealers; implementing a term deposit facility that would be available to depository institutions in order to reduce the supply of excess reserves; and taking steps to tighten the link between the interest rate paid on reserve balances held at the Federal Reserve Banks and the federal funds rate. Several participants noted the need to continue refining the Committee's strategy for an eventual withdrawal of policy accommodation. The staff also updated the Committee on developments in the Term Asset-Backed Securities Loan Facility (TALF), summarized the pros and cons of expanding the range of collateral eligible for TALF loans, and recommended extending the final date for making new TALF loans into 2010. Participants generally supported the extension of TALF into 2010 but were skeptical about expanding the range of assets at this time.

Secretary's note: As announced on August 17, 2009, the Board of Governors subsequently approved an extension of the TALF while holding in abeyance any further expansion in the types of collateral eligible for the TALF.

Staff Review of the Economic Situation

The information reviewed at the August 11–12 meeting suggested that overall economic activity was stabilizing after a contraction in real gross domestic product (GDP) during 2008 and early 2009 that the Bureau of Economic Analysis recently reported to have been greater than it had previously estimated. Employment continued to move lower through July, but the pace of job losses had slowed noticeably in recent months. A sizable pickup in motor vehicle production appeared to be under way. Housing activity apparently was beginning to turn up. Consumer spending dropped only a little further in the first half of this year, on balance, after falling sharply in the second half of last year. The decline in equipment and software (E&S) investment seemed to be moderating, although the incoming data did not point to an imminent recovery. The sharp cuts in production this year reduced inventory stocks significantly, though they remained high relative to the level of sales. A jump in gasoline prices pushed up overall consumer price inflation in June, but core consumer price inflation remained relatively stable in recent months.

Job losses continued to abate in July, and aggregate hours of production and nonsupervisory workers were unchanged. The step-up in motor vehicle assemblies boosted employment in that industry; job losses decreased in a number of other manufacturing industries, and factory workweeks generally rose. Employment declines in business and financial services in July were also smaller than those in recent months. Payrolls in nonbusiness services posted their third monthly gain, supported by the continued uptrend in health and education and a small gain in the leisure and hospitality industry. However, job losses in the construction industry continued at about the recent rate. In the household survey, the unemployment rate edged down in July to 9.4 percent, while the labor force participation rate fell back to its March level. Other indicators also suggested a reduced pace of deterioration in labor demand. Both initial claims for unemployment insurance and insured unemployment moved down since June. However, with labor markets still quite slack, year-over-year growth in average hourly earnings of production and nonsupervisory workers slowed further in July.

The contraction in industrial production slowed markedly in the second quarter, although the rate of decline remained rapid and the factory utilization rate recorded a new low in June. The moderation in the pace of decline in industrial production in the second quarter was widespread across industries and major market groups. Available indicators suggested that industrial production increased noticeably in July, led by motor vehicle assemblies; manufacturing output excluding motor vehicles likely also rose in July.

Real personal consumption expenditures (PCE) edged down in June after holding steady in May and declining in April. Apart from a jump in motor vehicle purchases, which were boosted appreciably by the government's "cash-for-clunkers" program, indicators of consumer spending in July were mixed. Most determinants of spending remained weak on balance. In particular, the weak labor market continued to place significant strains on household income, and earlier declines in net worth were still holding back spending. However, household net worth received a boost from the rise in equity prices since their low in March. In addition, the July Senior Loan Officer Opinion Survey on Bank Lending Practices indicated that the fraction of banks tightening standards and terms for consumer credit had diminished further. Moreover, measures of consumer sentiment, though they recently retraced a portion of their earlier gains, remained well above levels seen at the turn of the year.

Data from the housing sector indicated that construction activity appeared to be emerging from its extended decline. Single-family housing starts registered a sizable increase in June, and the number of starts stood well above the record low recorded in the first quarter of this year. However, in the much smaller multifamily sector, starts continued to decline, on net, in 2009 after falling significantly in the second half of 2008 amid tight credit conditions and rapidly deteriorating demand fundamentals for apartment buildings. The latest sales data suggested that demand for new houses may be strengthening after stabilizing in the early portion of this year. Although sales remained quite modest, they were enough, given the very slow pace of production, to pare the overhang of unsold new single-family houses: In June, these inventories stood at about one-half of their peak in the summer of 2006, and the months' supply of new homes was down considerably from its record high in January. Sales of existing single-family houses, which were fairly flat early in the year, posted their third consecutive monthly increase in June, and pending home sales agreements through June suggested that resale activity would rise further in the months ahead. Sales of existing homes had been supported for much of the year by heightened volumes of transactions involving bank-owned and other distressed properties; the uptick in May and June, however, appeared to have been driven by an increase in transactions of non-distressed properties. The apparent stabilization in housing demand seen in recent months was likely due, in part, to improvements in housing affordability stemming from low interest rates for conforming mortgages and lower house prices.

Real investment in E&S continued to contract in the second quarter; however, the estimated rate of decline was substantially smaller than in the previous two quarters. Business outlays on motor vehicles leveled off in the second quarter after an extended period of steep declines. Real spending in the high-tech sector declined, although real outlays for computing equipment posted their first gain in a year. Outside of high-tech and transportation, real spending on equipment dropped again in the second quarter but at a slower pace than in the previous quarter. Although the fundamental determinants of investment in E&S remained weak, conditions appeared less unfavorable, on balance, than earlier in the year. In particular, the decline in business output was less pronounced in the second quarter than in prior quarters, and estimates of the user cost of capital fell back somewhat in the second quarter after spiking last year. Other forward-looking indicators generally improved, but they remained at levels consistent with a weak outlook for E&S investment. Corporate bond spreads over Treasury securities continued to ease, and monthly surveys of business conditions and sentiment generally were less downbeat than earlier in the year. In addition, the July Senior Loan Officer Opinion Survey reported that the net percentage of banks that had tightened standards and terms on commercial and industrial (C&I) loans receded somewhat, although the July National Federation of Independent Business survey showed that the share of small businesses reporting increased difficulty in obtaining credit remained high. Conditions in the nonresidential construction sector generally remained quite poor, with spending in most major categories staying on a downward trajectory through June. Vacancy rates continued to rise, property prices fell further, and, as indicated by the July Senior Loan Officer Opinion Survey, financing for nonresidential construction projects became even tighter.

In May, the U.S. international trade deficit narrowed to its lowest level since 1999, as exports increased moderately and imports declined. The increase in exports of goods and services was led by a climb in exports of industrial supplies, particularly of petroleum products, and reflected both higher prices and greater volumes. The value of imports of goods and services fell at a slower pace than in April. Imports of petroleum products exhibited the largest decline, with the fall wholly reflecting lower volumes, as petroleum prices rose. Imports of services and automotive products moved down somewhat, while non-oil industrial supplies were largely unchanged. Overall imports of consumer goods were also about unchanged, as a large decline in pharmaceuticals offset increases in a number of other goods. In contrast, imports of computers moved up strongly in May.

Recent indicators of economic activity in the advanced foreign economies suggested that the pace of contraction in those countries moderated further. Purchasing managers indexes continued to rebound but did not yet point to expansion for all countries. Industrial production, while remaining well below pre-crisis levels, moved up strongly in Japan and edged up in the euro area and in the United Kingdom. Indicators of economic sentiment also improved. However, labor market conditions continued to deteriorate, and credit standards remained generally tight. In emerging market economies, recent data showed that economic activity surged across emerging Asia in the second quarter. Real GDP rebounded sharply in China and South Korea, and the preliminary estimate in Singapore indicated a substantial increase. In China, policy stimulus lifted activity and thus helped boost China's imports, primarily from other countries in Asia. Indicators for these other countries also pointed to a strong rebound in the second quarter. Activity remained depressed in Mexico, partly reflecting the adverse effect of a swine flu outbreak. In contrast, activity in Brazil appeared to have begun to recover.

In the United States, overall PCE prices rose in June following little change in each of the previous three months. The increase largely reflected a sizable increase in gasoline prices, which appeared to have caught up with earlier increases in crude oil prices. The latest available survey data showed that gasoline prices flattened out, on net, in July. Excluding food and energy, PCE prices moved up moderately in June. For the second quarter as a whole, core inflation picked up from the pace in the first quarter, which had been revised down because of smaller increases in the imputed prices of nonmarket services. Median year-ahead inflation expectations in the Reuters/University of Michigan Survey of Consumers held relatively steady in July, as in recent months. Longer-term inflation expectations were about the same as the average over 2008. The producer price index for core intermediate materials turned up in June following a string of monthly declines that likely reflected the pass-through of the large declines in spot prices of commodities in the second half of last year. All measures of hourly compensation and wages suggested that labor costs decelerated markedly this year in response to the considerable deterioration in labor market conditions.

Staff Review of the Financial Situation

The decisions by the Federal Open Market Committee (FOMC) at the June meeting to leave the target range for the federal funds rate unchanged and to maintain the sizes of its large-scale asset purchase programs, along with the accompanying statement, were broadly in line with market expectations. However, investors initially marked up their expected path for the federal funds rate following the release of the statement, as they apparently interpreted it as suggesting a more favorable assessment of prospects for economic growth than had been anticipated. Subsequently, investors revised down the expected policy path after the June employment report and the Chairman's semiannual monetary policy testimony. These declines were more than offset by the favorable economic information received toward the end of the intermeeting period, including the stronger-than-expected July employment report. On net, the market-implied path of the federal funds rate ended the period about the same as at the time of the June FOMC meeting. Yields on nominal Treasury securities were also little changed, on balance, over the intermeeting period, though there were sizable intraday movements in response to macroeconomic data releases and Federal Reserve communications. Inflation compensation based on five-year Treasury inflation-protected securities (TIPS) declined, on net, over the intermeeting period, while five-year inflation compensation five years ahead rose somewhat. Liquidity in the TIPS market reportedly continued to be poor, making unclear the extent to which movements in TIPS inflation compensation reflected changes in investors' expectations of future inflation.

Functioning in short-term funding markets generally showed further improvement over the intermeeting period. Consistent with reduced concerns about the financial condition of large banking institutions, London interbank offered rates (Libor) continued to edge down. Three- and six-month Libor-OIS (overnight index swap) spreads—while still somewhat elevated by historical standards—declined a bit further and stood at levels last recorded in early 2008. Bid-asked spreads for most types of repurchase agreements edged down. Since June, spreads on A2/P2-rated commercial paper and AA-rated asset-backed commercial paper were little changed, on net, remaining at the low ends of their ranges over the past two years. Indicators of Treasury market functioning were little changed over the intermeeting period, and functioning continued to be somewhat impaired. Bid-asked spreads held roughly steady, and trading volumes remained low. The on-the-run liquidity premium for the 10-year Treasury note was little changed at elevated levels, although it was well below its peak last fall.

Broad stock price indexes rose, on net, over the intermeeting period, as investors responded to strong second-quarter earnings reports and indications that the economy may be stabilizing. The spread between an estimate of the expected real equity return over the next 10 years for S&P 500 firms and an estimate of the real 10-year Treasury yield—a rough gauge of the equity risk premium—narrowed a bit more but remained high by recent historical standards. Option-implied volatility on the S&P 500 index also dropped a bit further. Yields on BBB-rated and speculative-grade corporate bonds declined over the intermeeting period. As a result, corporate bond spreads narrowed further and dropped below the previous peak levels reached in 2002 following the 2001 recession. Conditions in the leveraged loan market continued to improve as secondary-market prices rose further and bid-asked spreads narrowed.

Investor sentiment toward the financial sector improved further over the intermeeting period, boosted, in part, by better-than-expected second-quarter earnings results at larger banking institutions. Over the period, bank equity prices rose, and credit default swap spreads on financial firms declined. Nonetheless, some investors commented that the positive upside surprises at large financial institutions were mostly related to investment banking and trading activities, which may not provide a stable source of earnings, and to mortgage refinancing activity, which may recede if longer-term rates rise. Market participants also focused on the large consumer loan losses reported by many banks. The financial condition of CIT Group, Inc., one of the largest lenders to middle-market firms, worsened sharply over the period, but broader financial market conditions appeared to be largely unaffected by this development.

The level of private domestic nonfinancial sector debt apparently declined again in the second quarter, as household debt was estimated to have dropped and nonfinancial business debt appeared to have been essentially unchanged. Gross issuance of speculative- and investment-grade bonds by nonfinancial corporations slowed in July from its outsized second-quarter pace. Issuance of institutional loans in the syndicated leveraged loan market reportedly remained extremely weak in July, while bank loans and commercial paper continued to run off, leaving net debt financing by nonfinancial corporations at around zero. In contrast, the federal government issued debt at a rapid clip, and state and local government debt was estimated to have expanded moderately.

Commercial bank credit contracted further in June and July. All major loan categories declined, apparently reflecting the combined effects of weaker demand for most types of loans, some substitution from bank loans to other funding sources, and an ongoing tightening of lending standards and terms. Commercial and industrial lending dropped steeply amid subdued origination activity and broad-based paydowns of outstanding loans. In the July Senior Loan Officer Opinion Survey, respondents indicated that the most important reasons for the decline in C&I loans in 2009 were weaker demand from creditworthy borrowers and the deterioration in credit quality that had reduced the number of firms that respondents viewed as creditworthy. The contraction in commercial real estate (CRE) lending accelerated. Large fractions of respondents to the July survey again noted that they had tightened standards and that the demand for CRE loans had weakened further.

M2 was little changed, on net, in June and July. Retail money market mutual funds and small time deposits dropped significantly in June and were estimated to have contracted again in July, likely reflecting the very low rates of interest on these assets and a continued reallocation of wealth toward riskier assets. These declines were partly offset by a net increase in liquid deposits, also suggesting some portfolio reallocation within M2 assets. Currency expanded weakly, apparently because of soft foreign demand.

The tone of financial markets abroad improved further during the intermeeting period. Stock markets rose globally, as positive U.S. earnings reports and news of strong economic rebounds in emerging Asian economies reportedly lifted investor sentiment. European bank stocks rose especially rapidly, spurred by reports of better-than-expected earnings among some European banks as well as some U.S. financial institutions. The dollar depreciated mildly on a trade-weighted basis since late June.

The European Central Bank (ECB), the Bank of England, the Bank of Canada, and the Bank of Japan kept their respective policy rates constant over the intermeeting period. However, overnight interest rates in the euro area declined in the wake of the June 24 injection by the ECB of one-year funds at a fixed rate of 1 percent. The ECB also began its purchases of covered bonds, and yields on intermediate-term European covered bonds declined since the purchases began in early July. After leaving the size of its Asset Purchase Facility (APF) unchanged at its July meeting, the Bank of England, at its August meeting, raised the size of the APF to £175 billion and widened the set of gilts it would purchase. Benchmark gilt yields fell noticeably on the announcement after moving higher in July.

Staff Economic Outlook

In the forecast prepared for the August FOMC meeting, the staff's outlook for the change in real activity over the next year and a half was essentially the same as at the time of the June meeting. Consumer spending had been on the soft side lately. The new estimates of real disposable income that were reported in the comprehensive revision to the national income and product accounts showed a noticeably slower increase in 2008 and the first half of 2009 than previously thought. By themselves, the revised income estimates would imply a lower forecast of consumer spending in coming quarters. But this negative influence on aggregate demand was roughly offset by other factors, including higher household net worth as a result of the rise in equity prices since March, lower corporate bond rates and spreads, a lower dollar, and a stronger forecast for foreign economic activity. All told, the staff continued to project that real GDP would start to increase in the second half of 2009 and that output growth would pick up to a pace somewhat above its potential rate in 2010. The projected increase in production in the second half of 2009 was expected to be the result of a slowing in the pace of inventory liquidation; final sales were not projected to increase until 2010. The step-up in economic activity in 2010 was expected to be supported by an ongoing improvement in financial conditions, which, along with accommodative monetary policy, was projected to set the stage for further improvements in household and business sentiment and an acceleration in aggregate demand.

The staff forecast for inflation was also about unchanged from that at the June meeting. Interpretation of the incoming data on core PCE inflation was complicated by changes in the definition of the core measure recently implemented by the Bureau of Economic Analysis, as well as by unusually low readings for some nonmarket components of the price index.[13] After accounting for these factors, the underlying pace of core inflation seemed to be running a little higher than the staff had anticipated. Survey measures of inflation expectations showed no significant change. Nonetheless, with the unemployment rate anticipated to increase somewhat during the remainder of 2009 and to decline only gradually in 2010, the staff still expected core PCE inflation to slow substantially over the forecast period; the very low readings on hourly compensation lately suggested that such a process might already be in train.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and outlook, meeting participants agreed that the incoming data and anecdotal evidence had strengthened their confidence that the downturn in economic activity was ending and that growth was likely to resume in the second half of the year. Many noted that their baseline projections for the second half of 2009 and for subsequent years had not changed appreciably since the Committee met in June but that they now saw smaller downside risks. Consumer spending appeared to be in the process of leveling out, and activity in a number of local housing markets had stabilized or even increased somewhat. Reports from business contacts supported the view that firms were making progress in bringing inventories into better alignment with their reduced sales and that production was stabilizing in many sectors—albeit at low levels—and beginning to rise in some. Nonetheless, most participants saw the economy as likely to recover only slowly during the second half of this year, and all saw it as still vulnerable to adverse shocks. Conditions in the labor market remained poor, and business contacts generally indicated that firms would be quite cautious in hiring when demand for their products picks up. Moreover, declines in employment and weakness in growth of labor compensation meant that income

13. As part of the July 2009 comprehensive revision of the national income and product accounts, the Bureau of Economic Analysis reclassified restaurant meals from the food category to the services category. As a result, the price index for PCE excluding food and energy (the core PCE price index) now includes prices of restaurant meals.

growth was sluggish. Also, households likely would continue to face unusually tight credit conditions. These factors, along with past declines in wealth that had been only partly offset by recent increases in equity prices, would weigh on consumer spending. The data and business contacts indicated very substantial excess capacity in many sectors; this excess capacity, along with the tight credit conditions facing many firms, likely would mean further weakness in business fixed investment for a time. Even so, less-aggressive inventory cutting and continuing monetary and fiscal policy stimulus could be expected to support growth in production during the second half of 2009 and into 2010. In addition, the outlook for foreign economies had improved somewhat, auguring well for U.S. exports. Participants expected the pace of recovery to pick up in 2010, but they expressed a range of views, and considerable uncertainty, about the likely strength of the upturn—particularly about the pace of projected gains in consumer spending and the extent to which credit conditions would normalize.

Most participants anticipated that substantial slack in resource utilization would lead to subdued and potentially declining wage and price inflation over the next few years; a few saw a risk of substantial disinflation. However, some pointed to the problems in measuring economic slack in real time, and several were skeptical that temporarily low levels of resource utilization would reduce inflation appreciably, given the loose empirical relationship of economic slack to inflation and the fact that the public did not appear to have reduced its expectations of inflation. Participants noted concerns among some analysts and business contacts that the sizable expansion of the Federal Reserve's balance sheet and large continuing federal budget deficits ultimately could lead to higher inflation if policies were not adjusted in a timely manner. To address these concerns, it would be important to continue communicating that the Federal Reserve has the tools and willingness to begin withdrawing monetary policy accommodation at the appropriate time to prevent any persistent increase in inflation.

Developments in financial markets during the intermeeting period were again seen as broadly positive; the cumulative improvement in market functioning since the spring was viewed as quite significant. Markets for corporate debt continued to improve, and private credit spreads narrowed further. With the TALF continuing to provide important support, markets for asset-backed securities also showed improvement, and recent issuance had neared levels observed prior to the second half of 2008. Higher equity prices appeared to result not only from generally better-than-expected corporate earnings, which seemed largely to reflect aggressive cost cutting, but also from a reduction in the perceived risk of extremely adverse outcomes and a consequent increase in investors' appetite for riskier assets. However, participants noted that many markets were still strained and that financial risks remain. The improvement in financial markets was due, in part, to support from various government programs, and market functioning might deteriorate as those programs wind down. While financial markets had improved, credit remained tight, with many banks—though fewer than in recent quarters—having reported that they again tightened loan standards and terms. Increases in interest rates and reductions in lines on credit cards were affecting small businesses as well as consumers. All categories of bank lending had continued to decline. Worsening credit quality was still cited by banks as an important reason for the tightening of credit conditions, though anecdotal evidence suggested that the deterioration in the credit quality of consumer loans might be slowing. Nonetheless, several participants noted that banks still faced a sizable risk of additional credit losses and that many small and medium-sized banks were vulnerable to deteriorating performance of commercial real estate loans. Participants again observed that obtaining or renewing financing for commercial real estate properties and projects was extremely difficult amid worsening fundamentals in that sector, though some noted anecdotal evidence that the addition of highly rated commercial MBS to the list of securities that can be pledged as collateral for TALF loans had contributed to an improvement in liquidity in that market.

Labor market conditions remained of particular concern to meeting participants. Though recent data indicated that the pace at which employment was declining had slowed appreciably, job losses remained sizable. Moreover, long-term unemployment and permanent separations continued to rise, suggesting possible problems of skill loss and a need for labor reallocation that could slow recovery in employment as the economy begins to expand. The unusually large fraction of those who were working part time for economic reasons and the unusually low level of the average workweek, combined with indications from business contacts that firms would resist hiring as sales and production turn up, also pointed to a period of modest job gains and thus a slow decline in the unemployment rate. Wages and benefits continued to decelerate, reflecting—in the judgment of many participants—substantial slack in labor markets. Several participants noted that the deceleration in labor costs should eventually support a pickup in hiring. Recently, however, it contributed to weakness in household incomes.

Consumer spending remained weak, but participants saw evidence that it was stabilizing, even before the boost to auto purchases provided by the cash-for-clunkers program. Real PCE declined little, on balance, during the first half of 2009 after dropping sharply during the second half of 2008 and was essentially constant during May and June. Several participants noted the recent rebound in equity prices and thus household wealth as a factor that was likely to support consumer spending. Many noted, however, that households still faced considerable headwinds, including reduced wealth, tight credit, high levels of debt, and uncertain job prospects. With these forces restraining spending, and with labor income likely to remain soft, participants generally expected no more than moderate growth in consumer spending going forward. An important source of uncertainty in the outlook for consumer spending was whether households' propensity to save, which had risen in recent quarters, would increase further: Analysis based on responses to past changes in wealth relative to income suggested that the personal saving rate could level out near its current value; however, there was some chance that the increased income volatility and reduced access to credit that had characterized recent experience could lead households to save a still-larger fraction of their incomes.

Regional surveys and anecdotal reports continued to indicate low levels of activity across many goods-producing industries and in the service sector, but they also pointed to some optimism about the outlook. Firms appeared to be making substantial progress in reducing inventories toward desired levels; indeed, inventories of motor vehicles appeared quite lean following earlier production shutdowns and the recent boost to sales from the cash-for-clunkers program. Accordingly, participants expected firms to slow the pace of inventory reduction by raising production; this adjustment was likely to make an important contribution to economic recovery in the second half of this year. In contrast, business contacts generally reported setting a high bar for increasing capital investment once sales pick up, because their firms now have unusually high levels of excess capacity.

In the residential real estate sector, home sales, prices, and construction had shown signs of stabilization in many areas and were increasing modestly in others, but a still-sizable inventory of unsold existing homes continued to restrain homebuilding. Commercial real estate activity, in contrast, was being weighed down by deteriorating fundamentals, including declining occupancy and rental rates; by falling prices; and by difficulty in refinancing loans on existing properties.

Manufacturing firms appeared to have benefitted recently from an earlier- and stronger-than-expected pickup in foreign economic activity, especially in Asia, and the resulting increase in demand for U.S. exports. Several participants noted that improving growth abroad would likely contribute to greater growth in U.S. exports going forward.

A number of participants noted that fiscal policy helped support the stabilization in economic activity, in part by buoying household incomes and by preventing even larger cuts in state and local government spending. Participants generally anticipated that fiscal stimulus already in train would contribute to growth in economic activity during the second half of 2009 and into 2010, but the stimulative effects of policy would fade as 2010 went on and would need to be replaced by private demand and income growth.

Committee Policy Action

In their discussion of monetary policy for the period ahead, Committee members agreed that the stance of monetary policy should not be changed at this meeting. Given the prospects for an initially modest economic recovery, substantial resource slack, and subdued inflation, the Committee agreed that it should maintain its target range for the federal funds rate at 0 to ¼ percent. The future path of the federal funds rate would continue to depend on the Committee's evolving outlook, but, for now, given their forecasts for only a gradual upturn in economic activity and subdued inflation, members thought it most likely that the federal funds rate would need to be maintained at an exceptionally low level for an extended period. With the downside risks to the economic outlook now considerably reduced but the economic recovery likely to be damped, the Committee also agreed that neither expansion nor contraction of its program of asset purchases was warranted at this time. The Committee did, however, decide to gradually slow the pace of the remainder of its purchases of $300 billion of Treasury securities and extend their completion to the end of October to help promote a smooth transition in markets. Members noted that, with the programs for purchases of agency debt and MBS not due to expire until the end of the year, it was not necessary to make decisions at this meeting about any potential modifications to those programs. The Committee agreed that it would continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase agency debt, agency MBS, and longer-term Treasury securities during the intermeeting period with the aim of providing support to private credit markets and economic activity. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of private credit market conditions. The Desk is expected to purchase up to $200 billion in housing-related agency debt and up to $1.25 trillion of agency MBS by the end of the year. The Desk is expected to purchase about $300 billion of longer-term Treasury securities by the end of October, gradually slowing the pace of these purchases until they are completed. The Committee anticipates that outright purchases of securities will cause the size of the Federal Reserve's balance sheet to expand significantly in coming months. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in June suggests that economic activity is leveling out. Conditions in financial markets have improved further in recent weeks. Household spending has continued to show signs of stabilizing but remains constrained by ongoing job losses, sluggish income growth, lower housing wealth, and tight credit. Businesses are still cutting back on fixed investment and staffing but are making progress in bringing inventory stocks into better alignment with sales. Although economic activity is likely to remain weak for a time, the Committee continues to anticipate that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will contribute to a gradual resumption of sustainable economic growth in a context of price stability.

The prices of energy and other commodities have risen of late. However, substantial resource slack is likely to dampen cost pressures, and the Committee expects that inflation will remain subdued for some time.

In these circumstances, the Federal Reserve will employ all available tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period. As previously announced, to provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve will purchase a total of up to $1.25 trillion of agency mortgage-backed securities and up to $200 billion of agency debt by the end of the year. In addition, the Federal Reserve is in the process of buying $300 billion of Treasury securities. To promote a smooth transition in markets as these purchases of Treasury securities are completed, the Committee has decided to gradually slow the pace of these transactions and anticipates that the full amount will be purchased by the end of October. The Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. The Federal Reserve is monitoring the size and composition of its balance sheet and will make adjustments to its credit and liquidity programs as warranted."

Voting for this action: Messrs. Bernanke and Dudley, Ms. Duke, Messrs. Evans, Kohn, Lacker, Lockhart, Tarullo, and Warsh, and Ms. Yellen.

Voting against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, September 22–23, 2009. The meeting adjourned at 11:40 a.m. on August 12, 2009.

Notation Vote

By notation vote completed on July 14, 2009, the Committee unanimously approved the minutes of the FOMC meeting held on June 23–24, 2009.

Brian F. Madigan
Secretary

Meeting Held on September 22–23, 2009

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, September 22, 2009, at 2:00 p.m. and continued on Wednesday, September 23, 2009, at 9:00 a.m.

Present:

Mr. Bernanke, Chairman
Mr. Dudley, Vice Chairman
Ms. Duke
Mr. Evans
Mr. Kohn
Mr. Lacker
Mr. Lockhart
Mr. Tarullo
Mr. Warsh
Ms. Yellen

Mr. Bullard, Ms. Cumming, Mr. Hoenig, Ms. Pianalto, and Mr. Rosengren, Alternate Members of the Federal Open Market Committee

Messrs. Fisher and Plosser, Presidents of the Federal Reserve Banks of Dallas and Philadelphia, respectively

Mr. Lyon, First Vice President, Federal Reserve Bank of Minneapolis

Mr. Madigan, Secretary and Economist
Mr. Luecke, Assistant Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Ashton, Assistant General Counsel
Mr. Sheets, Economist
Mr. Stockton, Economist

Messrs. Altig, Clouse, Connors, Kamin, Slifman, Sullivan, Tracy, Weinberg, and Wilcox, Associate Economists

Mr. Sack, Manager, System Open Market Account

Ms. Johnson, Secretary of the Board, Office of the Secretary, Board of Governors

Mr. Struckmeyer, Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

Ms. Barger and Mr. English, Deputy Directors, Divisions of Banking Supervision and Regulation and Monetary Affairs, respectively, Board of Governors

Ms. Robertson, Assistant to the Board, Office of Board Members, Board of Governors

Ms. Edwards, Messrs. Reifschneider and Wascher, Senior Associate Directors, Divisions of Monetary Affairs, Research and Statistics, and Research and Statistics, respectively, Board of Governors

Mr. Oliner, Senior Adviser, Division of Research and Statistics, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Mr. Williams, Records Management Analyst, Division of Monetary Affairs, Board of Governors

Mr. Connolly,[14] First Vice President, Federal Reserve Bank of Boston

Messrs. Fuhrer and Rosenblum, Executive Vice Presidents, Federal Reserve Banks of Boston and Dallas, respectively

Mr. Hakkio, Ms. Mester, Messrs. Rasche, Rudebusch, and Schweitzer, Senior Vice Presidents, Federal Reserve Banks of Kansas City, Philadelphia, St. Louis, San Francisco, and Cleveland, respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

Mr. McCarthy and Ms. O'Connor, Assistant Vice Presidents, Federal Reserve Bank of New York

Mr. Chatterjee, Senior Economic Advisor, Federal Reserve Bank of Philadelphia

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on recent developments in domestic and foreign financial markets. The Manager also reported on System open market operations in Treasury securities, agency debt, and agency mortgage-backed securities (MBS) since the Committee's August 11–12 meeting. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account during the intermeeting period. Since the Committee met in August, the Federal Reserve's total assets had risen about $125 billion, on balance, to approximately $2.1 trillion, as the System's purchases of securities exceeded a further decline in usage of the System's credit and liquidity facilities.

The staff briefed the Committee on the current status of the asset purchase programs. Participants noted that the primary influence of the programs is likely through the cumulative effect that they generate on the publicly available stocks of securities. However, they also observed that the rate of new purchases could have an effect on asset prices, especially of MBS. Given this possibility, participants remarked that a gradual reduction in the pace at which the Federal Reserve buys agency debt and agency MBS could help promote a smooth transition in markets as the announced asset purchases are completed. Participants observed that such a strategy would be similar to the approach adopted in August for the purchases of Treasury securities and generally viewed it as a useful step to mitigate the risk of a sharp change in yields as purchases end. Participants expressed a range of views about the rate at which asset purchases should be slowed. Some suggested tapering quickly and completing the purchases by year-end, while a few preferred slowing the rate of purchases over a longer period in order to maintain flexibility regarding the pace and the cumulative amount purchased and thus potentially better calibrate the programs to evolving economic and financial market conditions. Most participants supported extending purchases of agency debt and agency MBS through the first quarter of 2010.

14. Attended Tuesday's session only.

The staff also briefed the Committee on the likely implications of very high reserve balances for bank balance sheet management and for the economy. The staff's assessment, based in part on consultations with market participants, was that many banks were currently comfortable holding high levels of reserves as a means of managing liquidity risks, and these balances or further increases along the lines implied by the announced programs were not likely to crowd out other lending through pressures on capital positions. As the economy improves, however, banks could seek to lower their levels of reserve balances by purchasing securities, thereby putting downward pressure on market interest rates, or by easing their credit standards and terms in order to expand lending. Such effects, if significant, would provide further impetus to economic growth. The staff analysis indicated that these effects would likely emerge only gradually and that their magnitude could be quite limited. However, some participants thought that declining demand for reserves might already be putting downward pressure on yields. Participants expressed a range of views about the likely stimulative effect of a further expansion of reserve balances on economic activity, as well as the potential impact of elevated reserves on inflation expectations. Some meeting participants noted that the announced decrease in the balance in the Treasury's Supplementary Financing Account (SFA) would increase reserves in the banking system unless it were offset by Federal Reserve actions or by a further reduction in borrowing from the Federal Reserve's various credit and liquidity facilities, and that these increases could be expansionary. Others noted that the decrease in the SFA could well be temporary and, in any event, that the macroeconomic effects of the increase in reserves would probably be limited in the current environment.

The staff presented an update on the continuing development of several tools that could help support a smooth withdrawal of policy accommodation at the appropriate time. These measures included executing reverse repurchase agreements on a large scale, potentially with counterparties other than the primary dealers; implementing a term deposit facility, available to depository institutions, to reduce the supply of reserve balances; and taking steps to tighten the link between the interest rate paid on reserve balances held at the Federal Reserve Banks and the federal funds rate. Participants expressed confidence that these tools, along with the payment of interest on reserves and possible sales of assets from the System's portfolio, would allow them to remove policy accommodation at the appropriate time and pace. Completing development of these tools would remain a top priority of the Federal Reserve.

The staff presented proposed schedules for operations under the Term Auction Facility (TAF) and Term Securities Lending Facility (TSLF) through January 2010. As conditions in short-term funding markets had continued to improve, usage of these facilities had diminished. The proposed schedules were consistent with not only the Federal Reserve's previously announced intention to gradually scale back these facilities in response to continued improvements in financial market conditions, but also with a desire to assure market participants that the Federal Reserve will provide sufficient liquidity over year-end. There was general agreement that the Federal Reserve should assess over the next several months whether to maintain a TAF on a permanent basis.

Secretary's note: On September 24, 2009, the Federal Reserve announced schedules for operations under the TAF and the TSLF through January 2010 and indicated that it would seek public comment on a proposal for a permanent TAF.

Staff Review of the Economic Situation

The information reviewed at the September 22–23 meeting suggested that overall economic activity was beginning to pick up. Factory output, particularly motor vehicle production, rose in July and August. Consumer spending on motor vehicles during that period was boosted by government rebates and greater dealer incentives, and household spending outside of motor vehicles appeared to rise in August after having been roughly flat from May through July. Although employment continued to contract in August, the pace of job losses slowed noticeably from that of earlier in the year. Investment in equipment and software (E&S) also seemed to be stabilizing. Sales and construction of single-family homes during July and August, while still at low levels, were significantly above the readings at the beginning of the year. The sharp cuts in production this year reduced inventory stocks significantly, though they remained elevated relative to the recent level of sales. Core consumer price inflation continued to be subdued in July and August, but higher gasoline prices raised overall consumer price inflation in August.

Firms continued to reduce payrolls, but job losses abated further in August, with the decline in private payroll employment the smallest since that of August 2008. Although employment losses continued to be widespread, the rate of decline diminished in most industries. The length of the average workweek for production and nonsupervisory workers remained steady, albeit at a low level, and the rate of decline in aggregate hours for this group over July and August was the smallest of the past year. In the household survey, although the unemployment rate rose in August to 9.7 percent, the rise in the unemployment rate slowed, on net, in recent months from its pace earlier in the year. The labor force participation rate in August remained at the low level that had prevailed through much of the year. Continuing claims for unemployment insurance through regular state programs fell slightly, on balance, from its earlier peak, but the total including extended and emergency benefits stayed near its recent high level. Initial claims for unemployment insurance fluctuated within a narrow range that was consistent with further declines in employment. With labor markets still weak, the year-over-year increase in average hourly earnings of production and nonsupervisory workers slowed further in August, even with the higher federal minimum wage that went into effect at the end of July.

Industrial production rose in July and August, led by a rebound in motor vehicle production from the extraordinarily low assembly rates in the first half of the year. Manufacturing production outside of motor vehicles increased solidly, likely reflecting stronger demand for materials from the motor vehicle sector and a slower pace of inventory liquidation elsewhere. Business survey indicators suggested further gains in factory output over the near term. Nevertheless, the factory utilization rate in August was only modestly above its recent historical low.

Real personal consumption expenditures increased modestly in July, led by a strong advance in motor vehicle purchases, which were boosted appreciably by the government's "cash-for-clunkers" program. This program contributed to a further surge in motor vehicle sales in August to their highest level since the first half of 2008. After declining in July, sales at retailers, excluding those at motor vehicle dealers, building materials stores, and gasoline stations, rose significantly in August, suggesting an increase in real consumer expenditures on non-motor-vehicle goods for the month. Even so, many determinants of spending continued to be tepid. In particular, the weak labor market continued to restrain growth in household income, and the prior declines in household net worth probably continued to weigh on spending. However, an increase in household net worth since March, a rise in nominal labor compensation in July, and increases in various measures of consumer sentiment indicated some improvement in the outlook for consumer spending.

Data from the housing sector indicated that a gradual recovery in activity was under way. Although single-family housing starts fell modestly in August, this decrease followed five consecutive monthly increases, and the number of starts in August was well above the record low reached in the first quarter of the year. In contrast, in the much smaller multifamily sector, where credit conditions were still particularly tight and vacancy rates remained high, starts continued to be down, on net, in 2009 after a significant fall in the second half of 2008. The sales data for July indicated further increases in the demand for both new and existing single-family homes. Even though new home sales remained modest, they had been sufficient, given the slow pace of construction, to pare the overhang of unsold new single-family houses: In July, the level of inventories of such homes was about one-half of its peak in the summer of 2006, and the months' supply had fallen considerably from its record high in January. Sales of existing homes in July were at their fastest pace since mid-2007, and pending home sales agreements suggested that resale activity would rise further in following months. Although sales of distressed properties remained elevated, the rise in total sales of existing homes over the summer appeared to have been driven by an increase in transactions involving nondistressed properties. The apparent modest strengthening of housing demand was likely due, in part, to improvements in housing affordability stemming from low interest rates for conforming mortgages, a lower level of house prices, and possibly the first-time homebuyer tax credit. In addition, demand may have been buoyed by a sense that house prices were beginning to stabilize. Through the end of the second quarter, many house price indexes had smaller year-over-year declines than they had shown earlier this year, and some indexes recorded positive changes for the second quarter.

Real spending on E&S appeared to be stabilizing after falling sharply for more than a year. Business purchases of transportation equipment seemed to be expanding solidly in the third quarter. Nominal shipments and orders for high-tech equipment in July were significantly above their second-quarter averages; moreover, a few major producers of high-tech equipment reported some signs of improvement in demand. Business investment in equipment other than high tech and transportation showed tentative signs of stabilization. Some forward-looking indicators of investment in E&S improved, suggesting that conditions had become less adverse than earlier in the year. Monthly surveys of business conditions and sentiment recently recovered to levels consistent with a modest rise in business spending, and corporate bond spreads over Treasury securities narrowed further. In contrast, conditions in the nonresidential construction sector generally remained quite poor, and measures of construction spending excluding energy-related projects stayed on a downward trajectory through July. Vacancy rates continued to rise, property prices fell further, and financing for nonresidential construction projects remained very tight. The nominal book value of businesses inventories continued to fall in July, which contributed to further declines in inventory-to-sales ratios; however, those ratios stayed elevated.

After narrowing to a 10-year low in May, the U.S. international trade deficit widened in June and July, as strong increases in exports were more than offset by sizable rises in imports. The July trade data provided additional evidence that the levels of both exports and imports probably reached their trough in the second quarter. About one-half of the increase in exports of goods and services in July was in exports of automotive products; the other gains were widespread across other major categories of exports. As with exports, the largest increase in imports of goods and services in July was in automotive products, reflecting some recovery in North American motor vehicle production. Imports of consumer goods, capital goods, and industrial supplies also rose markedly. Imports of oil increased more moderately, with the rise wholly reflecting higher prices.

Real gross domestic product (GDP) in the advanced foreign economies contracted more moderately in the second quarter than in the first quarter, with growth resuming in several countries. In Japan, a trade-related rebound in industrial production led to an increase in overall output. Government incentives for motor vehicle purchases contributed to a modest expansion of the German and French economies, but the euro-area economy as a whole contracted slightly as inventory drawdowns weighed on activity. Output also fell in Canada and the United Kingdom. Purchasing managers indexes (PMIs) rose further in the major economies during the intermeeting period, and reached levels consistent with stabilization or moderate expansion of output in the third quarter. Indicators of consumer sentiment continued to increase, but remained well below pre-recession levels, in part because of concerns about rising unemployment. In most emerging market economies, particularly in Asia, economic activity rebounded in the second quarter; however, output declined again in Mexico. Indicators of activity in the third quarter pointed to a continued expansion of output in most emerging market countries, and PMIs moved into the expansionary range in many of them. International trade in emerging market economies picked up, supported by Chinese demand, while demand from advanced economies still appeared weak.

In the United States, core consumer price inflation remained subdued in July and August, as price increases in housing services moderated and durable goods prices declined. Overall consumer price inflation increased in August, boosted by a sharp upturn in energy prices, particularly those of gasoline. The latest available survey data indicated that gasoline prices edged up further in the first half of September. Consumer food prices were little changed in August. According to the preliminary September release of the Reuters/University of Michigan Surveys of Consumers, median year-ahead inflation expectations decreased modestly in the first half of September, but remained somewhat above the low levels posted at the beginning of the year. Longer-term inflation expectations from this survey stayed in the narrow range that has prevailed over recent years. The producer price index for core intermediate materials rose in August, its third consecutive monthly increase; over those three months, the index retraced about one-third of the decline of the previous eight months. All measures of nominal hourly compensation and wages suggested that labor costs had decelerated markedly this year amid the considerable weakness in labor markets.

Staff Review of the Financial Situation

The decisions by the Federal Open Market Committee (FOMC) at the August meeting to leave the target range for the federal funds rate unchanged and to maintain the maximum sizes of its large-scale asset purchase programs, along with the accompanying statement, were broadly in line with market expectations. The announcement in the statement of the decision to slow the pace of Treasury securities purchases so that the full amount of $300 billion would be completed by the end of October reduced uncertainty about the timing of the end of this program and the ultimate amount of purchases. After the release of the statement, the expected path for the federal funds rate implied by money market futures prices declined modestly. Subsequently, the expected policy path shifted down further, on net, as investors apparently interpreted weak labor market conditions and generally quiescent inflation as consistent with an outlook that would lead the FOMC to maintain low policy rates over the medium term. In addition, investors' uncertainty about the future policy rate path appeared to diminish, which may have also contributed to the lowering of the path implied by futures prices by reducing term premiums. Yields on nominal Treasury securities also decreased since the Committee met in August. A decline in implied volatility on longer-term Treasury yields suggested that some of the drop in yields was due to reduced risk premiums. Inflation compensation based on five-year Treasury inflation-protected securities (TIPS) increased a little, on balance, over the intermeeting period, while five-year inflation compensation five years ahead declined modestly; the decrease in forward inflation compensation partially reversed increases in prior intermeeting periods. Liquidity in the TIPS market reportedly continued to be poor, complicating inferences about investors' expectations of future inflation.

Conditions in short-term funding markets showed modest further improvement over the intermeeting period. Spreads between London interbank offered rates (Libor) and overnight index swaps (OIS) at the one- and three-month maturities returned to near the levels that prevailed before the onset of the financial crisis in August 2007. Longer-term Libor-OIS spreads also narrowed, but they remained high by historical standards. Reports continued to suggest that lending institutions were unusually selective about their counterparties in funding markets. Spreads on A2/P2-rated commercial paper and AA-rated asset-backed commercial paper were little changed, on net, remaining at the low end of their ranges over the past two years. Indicators of Treasury market functioning showed no material change, and functioning continued to be somewhat impaired. Bid-asked spreads held roughly steady, and trading volumes remained low. The on-the-run liquidity premium for the 10-year Treasury note was little changed at an elevated level, although it was well below its peak last fall; the premiums on two- and five-year Treasury securities stayed low.

Amid lower interest rates as well as further indications that the contraction in economic activity may have ended, broad stock price indexes rose, on net, over the intermeeting period. The spread between an estimate of the expected real equity return over the next 10 years for S&P 500 firms and an estimate of the real 10-year Treasury yield—a rough gauge of the equity risk premium—remained high by historical standards. After having dropped significantly in prior months, option-implied volatility on the S&P 500 index declined modestly, on balance, over the intermeeting period, but was still at a level comparable with that of previous recessions. Yields on corporate bonds fell a bit more than those on Treasury securities of similar duration. Indicators suggested that liquidity in the secondary market for corporate bonds increased a bit further. Conditions in the secondary market for leveraged syndicated loans continued to improve slowly, as secondary-market prices rose slightly and bid-asked spreads narrowed.

Changes in investor sentiment toward claims on financial firms were mixed over the intermeeting period. Equity prices for larger banks increased, but stock prices for regional and smaller banks were little changed. Market participants reportedly took note of the increased number of failures at regional and smaller banks and remained concerned about the credit quality of such banks' loan portfolios and their ability to raise capital. Credit default swap spreads for banking institutions changed little, on net, over the intermeeting period. A number of financial institutions issued debt that was not guaranteed by the Federal Deposit Insurance Corporation.

The level of debt of the private domestic nonfinancial sector declined again in the second quarter, as both household and nonfinancial business debt fell. Consumer credit posted its sixth consecutive monthly decline in July; both revolving and nonrevolving credit showed sizable drops. While issuance of consumer credit asset-backed securities decreased in August, a large volume of securities eligible for the Term Asset-Backed Securities Loan Facility was issued in early September. Gross bond issuance by nonfinancial corporations rose in August following a lull in July; the rebound was particularly robust for speculative-grade firms. However, commercial paper outstanding was unchanged and bank loans fell again; as a result, borrowing by the nonfinancial business sector declined, on net, again in August. In contrast, the federal government continued to issue debt at a rapid pace, and gross issuance of state and local government debt was robust, supported in part by issuance of Build America Bonds authorized under the fiscal stimulus program.

Commercial bank credit contracted further in August; all major loan categories declined. Commercial and industrial (C&I) lending again decreased steeply amid reported broad-based paydowns of outstanding loans. At the same time, the latest Survey of Terms of Business Lending showed that C&I loan spreads over comparable-maturity market instruments rose noticeably in recent months. The contraction of commercial real estate loans held by banks also intensified in August. Even though originations of residential mortgages apparently increased during August, banks sold an unusually large volume of loans to the government-sponsored enterprises; consequently, banks' balance sheet holdings of residential mortgages decreased markedly.

After declining in July, M2 contracted more quickly in August. The reduced demand for M2 assets likely reflected low interest rates on retail deposits and money market mutual fund shares, as well as a continued reallocation of wealth toward riskier assets. Small time deposits and retail money market mutual funds fell more sharply in August than earlier in the year. Liquid deposits increased in August, but at a slower rate than in July. Currency expanded less rapidly in July and August than in the first half of the year, as demand from abroad evidently was restrained.

Global financial markets showed some further signs of stabilization over the intermeeting period. Stock indexes in Europe rose solidly, apparently reflecting an improved economic outlook, but the Japanese stock market declined modestly. In emerging markets, credit default swap spreads on sovereign debt declined slightly, and equity prices in most countries rose moderately; however, stock prices fell notably in China, partly driven by reports that authorities were taking actions to moderate loan growth. Despite fairly positive economic indicators, sovereign yields fell in major industrial economies, reportedly in part because of the reiteration by major central banks of their intention to keep policy interest rates low. On a trade-weighted basis, the dollar depreciated against major foreign currencies, notably against the euro and Japanese yen; it was little changed, on average, against the currencies of the other major trading partners of the United States.

The European Central Bank, the Bank of England, the Bank of Canada, and the Bank of Japan kept their respective policy rates constant over the intermeeting period. On the first day of the FOMC meeting, the Bank of Canada announced the expiration of two temporary liquidity facilities at the end of October 2009.

Staff Economic Outlook

In the forecast prepared for the September FOMC meeting, the staff raised its projection for real GDP growth over the second half of 2009 and over 2010. The information received during the intermeeting period appeared to indicate a more noticeable upturn than anticipated at the time of the August meeting: Sales and starts of single-family homes provided evidence of some firming in housing activity, capital spending indicators pointed to an earlier-than-anticipated trough for investment in E&S, and some data suggested a modest recovery in consumer spending. These tentative signs of a recovery of economic activity were supported by other factors, including recent rises in house and equity prices that would support household net worth, declines in interest rates on corporate bonds and fixed-rate mortgages, and a stronger outlook for activity in foreign economies. The staff expected that these positive factors would lead to a modest increase in final sales in the second half of 2009, despite continued weakness in commercial construction and some further deterioration in labor markets. As a result of the expected increase in final sales and an anticipated reduction in inventory liquidation, the staff projected that real GDP would increase in the second half of 2009 at a rate somewhat above the growth rate of potential output. For 2010, the staff forecast that output growth would continue to strengthen, supported by an ongoing improvement in financial conditions, a fading of the drag from earlier declines in income and wealth, accommodative monetary and fiscal policy, and recovery in the housing sector. These factors also contributed to an expected further increase in real GDP growth in 2011, despite an anticipated decline in the impetus from fiscal policy. Even though the upward revision to the projection for output was expected to generate larger gains in employment than previously forecast, the staff still projected only a slow improvement in labor markets, with the unemployment rate moving down to about 9¼ percent by the end of 2010 and then falling to about 8 percent by the end of 2011.

The staff forecast for inflation was little changed from that at the August meeting. The recent data on consumer price inflation were a little above staff expectations, but still indicated a slower increase in core prices compared with those of earlier in the year. Survey measures of inflation expectations displayed no significant change. Nonetheless, with the significant underutilization of resources expected to persist through 2011, the staff forecast core inflation to slow somewhat further over the next two years from the pace of the first half of 2009. Because of recent increases in energy prices, overall consumer price inflation was projected to be somewhat above core inflation in the second half of 2009 and 2010, but it was expected to be near the core rate in 2011.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and outlook, meeting participants agreed that the incoming data and information received from business contacts suggested that economic activity had picked up following its severe downturn; most thought an economic recovery was under way. Many participants noted that since August, they had revised up their projections for the second half of 2009 and for subsequent years. A number of factors were expected to support growth over the next few quarters: Activity in the housing sector was evidently rising, and house prices had apparently stabilized or even increased; consumer spending seemed to be in the process of leveling out; reports from business contacts and regional surveys were consistent with firms making progress in bringing inventories into better alignment with sales and with production stabilizing or beginning to rise in many sectors; the outlook for growth abroad had also improved, auguring well for U.S. exports; and financial market conditions had continued to improve over the past several months. Despite these positive factors, many participants noted that the economic recovery was likely to be quite restrained. Credit from banks remained difficult to obtain and costly for many borrowers; these conditions were expected to improve only gradually. In light of recent experience, consumers were likely to be cautious in spending, and business contacts indicated that their firms would also be cautious in hiring and investing even as demand for their products picked up. Some of the recent gains in activity probably reflected government policy support, and participants expressed considerable uncertainty about the likely strength of the upturn once those supports were withdrawn or their effects waned. Overall, the economy was projected to expand over the remainder of 2009 and during 2010, but at a pace that was unlikely to reduce the unemployment rate appreciably. Subsequently, as the housing market picked up further and financial conditions improved, economic growth was expected to strengthen, leading to more-substantial increases in resource utilization over time.

Nonetheless, most participants anticipated that slack in both labor and product markets would be substantial over the next few years, leading to subdued and potentially declining wage and price inflation. Some participants were skeptical of the usefulness of measures of resource utilization in gauging inflation pressures, partly because of the difficulty of measuring slack, especially in real time. Also, those participants noted that the degree to which slack reduces inflation depends on the stability of longer-term inflation expectations, which in turn depends on expectations for monetary policy. In any case, all participants recognized that inflation expectations are a key determinant of inflation, and that various measures of inflation expectations, although imperfect, needed to be carefully monitored in the current environment. Participants discussed the extent to which the size of the Federal Reserve's balance sheet would affect inflation expectations going forward. To keep inflation expectations well anchored, all agreed on the importance of the Federal Reserve continuing to communicate that it has the tools and willingness to begin withdrawing monetary policy accommodation at the appropriate time and pace to prevent any persistent increase in inflation. Overall, many participants viewed the risks to their inflation outlook over the next few quarters as being roughly balanced. A few continued to see some risk of substantial further disinflation, but that risk had eased somewhat further over the intermeeting period. Over a longer horizon, a few felt the risks were tilted to the upside.

Developments in financial markets were again regarded as broadly positive; participants saw the cumulative improvement in market functioning and pricing since the spring as substantial. Over the intermeeting period, the strengthening in the economic outlook led to an increase in investors' appetite for riskier assets. Markets for corporate debt continued to improve, private credit spreads narrowed further, and equity prices rose. Given the improved economic prospects, the decline in longer-term Treasury yields and the apparent marking down of the implied path for the policy interest rate were seen as somewhat puzzling but supportive of recovery. Some participants saw the decline in yields on Treasury securities and other instruments as an indication that the expansion of excess reserve balances was putting downward pressure on market rates; some others viewed the configuration of rate movements as consistent with reduced concerns about inflation and with lower term premiums in a more settled economic environment. In any event, the ongoing improvement in broader financial and economic conditions seemed to some participants to reflect the onset of a positive feedback loop in which better financial conditions contribute to stronger growth in output and employment, which in turn bolsters expected returns and strengthens financial firms, leading to a further easing in financial conditions. Others noted, however, that many financial markets and institutions were still strained and that downside financial risks remained. In particular, because the improvement in financial markets was due, in part, to support from various government programs, market functioning might deteriorate as those programs wind down. Moreover, credit remained quite tight for many businesses and households dependent on banks, and many regional and small banks were vulnerable to the deteriorating performance of commercial real estate loans. Participants noted that all categories of bank lending continued to decline.

Participants emphasized that labor market conditions remained weak. Although recent data indicated that the pace at which employment was declining had slowed, job losses remained sizable and the unemployment rate was high. The unusually large fraction of those who were working part time for economic reasons, the unusually low level of the average workweek, and indications from business contacts that firms would be slow to hire additional staff as sales and production turn up all pointed to a period of modest job gains, and thus only a slow decline in the unemployment rate as the economic recovery proceeds. Significant cost cutting by firms was thought to have led to a sizable increase in productivity growth in the first half of the year; sustained outsized gains in productivity could further damp hiring. Finally, high levels of long-term unemployment and permanent separations could lead to losses of skills and greater needs for labor reallocation that could slow employment growth.

Consumer spending had picked up more than expected over the intermeeting period, but participants saw that increase as partly reflecting special factors like the cash-for-clunkers program. Recent increases in house prices and equity prices were positives, but participants generally expected no more than moderate growth in consumer spending over the near term. Households still faced considerable headwinds, including tight credit, high levels of debt, uncertain job prospects, and wealth levels that remained relatively low despite the recent rise in equity prices and stabilization in house prices. In that environment, households' saving behavior remained an important source of uncertainty in the outlook. The household saving rate had risen considerably in recent quarters, and the most likely outcome was for the saving rate to remain near its higher level; however, some participants noted that there was some chance that the sharp drop in household net worth over the past few years, reduced access to credit, and high household debt burdens could lead households to save a substantially larger fraction of their incomes going forward.

Firms appeared to be reducing inventories and fixed investment at a slower pace than earlier in the year and had made substantial progress in reducing stocks toward desired levels. With inventories low, firms were beginning to raise production to meet at least a portion of new demand; this adjustment was likely to make an important contribution to economic recovery in the second half of this year. Recent data on new orders and shipments pointed to an earlier bottoming out in equipment and investment spending than previously anticipated. Some participants reported that while business contacts had expressed relief that the most severe economic outcomes had been avoided, they remained cautious about the recovery. This caution, together with low utilization rates and substantial excess capacity, could hold back the rate of increase of new capital spending.

In the residential real estate sector, home sales and construction had increased from very low levels, and house prices appeared to be stabilizing. Participants welcomed the cumulating evidence that the housing sector was beginning to recover, and many participants had marked up their forecasts for housing activity. However, some viewed the improvement as quite tentative, pointing to the pending termination of the temporary tax credit for first-time homebuyers and the winding down of the Federal Reserve's agency MBS purchase program as potential risks to the outlook for the sector. Also, some participants questioned whether the recent stabilization in house prices would be sustained as likely further increases in foreclosures would probably put downward pressure on prices. Still, a better outlook for house prices was an important input to the improved economic outlook; not only would household wealth benefit from a turnaround in such prices, but the exposure of lenders to real estate losses would be diminished. In contrast to developments in the residential sector, commercial real estate activity continued to fall markedly in most districts, reflecting deteriorating fundamentals, including declining occupancy and rental rates and very tight credit conditions.

Participants marked up their outlook for foreign economies, mainly reflecting better-than-expected incoming data from a range of countries. The pickup in foreign economic activity, especially in Asia, had buoyed U.S. export growth, and several participants noted that higher growth abroad would support growth in U.S. exports going forward.

Committee Policy Action

In their discussion of monetary policy for the period ahead, Committee members agreed that no significant changes to its policy target rate or large-scale asset purchase programs were warranted at this meeting. Although the economic outlook had improved further in recent weeks and the risks to the forecast had become more balanced, the level of economic activity was likely to be quite weak and resource utilization low. With substantial resource slack likely to persist and longer-term inflation expectations stable, the Committee anticipated that inflation would remain subdued for some time. Under these circumstances, the Committee judged that the costs of growth turning out to be weaker than anticipated could be relatively high. Accordingly, the Committee agreed that it was appropriate to maintain its target range for the federal funds rate at 0 to ¼ percent and to reiterate its view that economic conditions were likely to warrant an exceptionally low level of the federal funds rate for an extended period. With respect to the large-scale asset purchase programs, some members thought that an increase in the maximum amount of the Committee's purchases of agency MBS could help to reduce economic slack more quickly than in the baseline outlook. Another member believed that the recent improvement in the economic outlook could warrant a reduction in the Committee's maximum purchases. However, all members were able to support an indication by the Committee of its intention at this time to purchase the full $1.25 trillion of agency MBS that it had previously established as the maximum for this program. With respect to agency debt, the Committee agreed to reiterate its intention to purchase up to

$200 billion of these securities. To promote a smooth transition in markets as these programs are concluded, members decided to gradually slow the pace of both its agency MBS and agency debt purchases and to extend their completion through the end of the first quarter of 2010. The Committee agreed that it would continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. Members discussed the importance of maintaining flexibility to expand the asset purchase programs should the economic outlook deteriorate or to scale back the programs should economic and financial conditions improve more than anticipated.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase agency debt, agency MBS, and longer-term Treasury securities during the intermeeting period with the aim of providing support to private credit markets and economic activity. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of private credit market conditions. The Desk is expected to complete purchases of about $300 billion of longer-term Treasury securities by the end of October. It is also expected to execute purchases of up to $200 billion in housing-related agency debt and about $1.25 trillion of agency MBS by the end of the first quarter of 2010. The Desk is expected to gradually slow the pace of these purchases as they near completion. The Committee anticipates that outright purchases of securities will cause the size of the Federal Reserve's balance sheet to expand significantly in coming months. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in August suggests that economic activity has picked up following its severe downturn. Conditions in financial markets have improved further, and activity in the housing sector has increased. Household spending seems to be stabilizing, but remains constrained by ongoing job losses, sluggish income growth, lower housing wealth, and tight credit. Businesses are still cutting back on fixed investment and staffing, though at a slower pace; they continue to make progress in bringing inventory stocks into better alignment with sales. Although economic activity is likely to remain weak for a time, the Committee anticipates that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will support a strengthening of economic growth and a gradual return to higher levels of resource utilization in a context of price stability.

With substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.

In these circumstances, the Federal Reserve will continue to employ a wide range of tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve will purchase a total of $1.25 trillion of agency mortgage-backed securities and up to $200 billion of agency debt. The Committee will gradually slow the pace of these purchases in order to promote a smooth transition in markets and anticipates that they will be executed by the end of the first quarter of 2010. As previously announced, the Federal Reserve's purchases of $300 billion of Treasury securities will be completed by the end of October 2009. The Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. The Federal Reserve is monitoring the size and composition of its balance sheet and will make adjustments to its credit and liquidity programs as warranted."

Voting for this action: Messrs. Bernanke and Dudley, Ms. Duke, Messrs. Evans, Kohn, Lacker, Lockhart, Tarullo, and Warsh, and Ms. Yellen.

Voting against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, November 3–4, 2009. The meeting adjourned at 12:35 p.m. on September 23, 2009.

Notation Votes

By notation vote completed on August 28, 2009, the Committee unanimously approved the designation of Matthew M. Luecke as the Committee's Chief Freedom of Information Act Officer, with authority to subdelegate duties as appropriate.

By notation vote completed on September 1, 2009, the Committee unanimously approved the minutes of the FOMC meeting held on August 11–12, 2009.

Brian F. Madigan
Secretary

Meeting Held on November 3–4, 2009

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, November 3, 2009, at 2:00 p.m. and continued on Wednesday, November 4, 2009, at 9:00 a.m.

Present:

Mr. Bernanke, Chairman
Mr. Dudley, Vice Chairman
Ms. Duke
Mr. Evans
Mr. Kohn
Mr. Lacker
Mr. Lockhart
Mr. Tarullo
Mr. Warsh
Ms. Yellen

Mr. Bullard, Mr. Hoenig, Ms. Pianalto, and Mr. Rosengren, Alternate Members of the Federal Open Market Committee

Messrs. Fisher, Kocherlakota, and Plosser, Presidents of the Federal Reserve Banks of Dallas, Minneapolis, and Philadelphia, respectively

Mr. Madigan, Secretary and Economist
Mr. Luecke, Assistant Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Sheets, Economist
Mr. Stockton, Economist

Messrs. Altig, Clouse, Connors, Kamin, Slifman, Sullivan, Wilcox, and Williams, Associate Economists

Mr. Sack, Manager, System Open Market Account

Ms. Johnson, Secretary of the Board, Office of the Secretary, Board of Governors

Mr. Frierson, Deputy Secretary, Office of the Secretary, Board of Governors

Mr. Struckmeyer, Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

Mr. English, Deputy Director, Division of Monetary Affairs, Board of Governors

Ms. Robertson, Assistant to the Board, Office of Board Members, Board of Governors

Ms. Edwards, Messrs. Levin and Nelson, Senior Associate Directors, Division of Monetary Affairs, Board of Governors; Messrs. Reifschneider and Wascher, Senior Associate Directors, Division of Research and Statistics, Board of Governors

Mr. Leahy,[15] Associate Director, Division of International Finance, Board of Governors

Mr. Palumbo, Deputy Associate Director, Division of Research and Statistics, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Ms. Ihrig, Section Chief, Division of Monetary Affairs, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

Mr. Williams, Records Management Analyst, Division of Monetary Affairs, Board of Governors

Ms. Holcomb, First Vice President, Federal Reserve Bank of Dallas

Messrs. Fuhrer and Sniderman, Executive Vice Presidents, Federal Reserve Banks of Boston and Cleveland, respectively

Mr. Barkema, Mses. Mester and Mosser, and Mr. Waller, Senior Vice Presidents, Federal Reserve Banks of Kansas City, Philadelphia, New York, and St. Louis, respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

Mr. Burke and Ms. Yucel, Vice Presidents, Federal Reserve Banks of New York and Dallas, respectively

Ms. Sbordone and Mr. Sill, Assistant Vice Presidents, Federal Reserve Banks of New York and Philadelphia, respectively

Mr. Hetzel, Senior Economist, Federal Reserve Bank of Richmond

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on recent developments in domestic and foreign financial markets. The Manager also reported on System open market operations in Treasury securities, agency debt, and agency mortgage-backed securities (MBS) since the Committee's September 22–23 meeting. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account during the intermeeting period. Since the Committee met in September, the Federal Reserve's total assets were about unchanged, on balance, at approximately \$2.2 trillion, as the increase in the System's holdings of securities roughly matched a further decline in usage of the System's credit and liquidity facili-

15. Attended the portion of the meeting relating to financial developments, open market operations, and System facilities.

ties. The Manager noted that, as of October 30, $300 billion in Treasury securities had been purchased, as directed by the Committee. Overall, the Treasury market had recovered substantially from the strains during the financial crisis, and the Manager reported that the completion of the Federal Reserve's purchase program did not appear to have led to any significant upward pressure on Treasury yields or to any notable deterioration in Treasury market functioning. There was little evidence, to date, of a buildup in year-end funding pressures, although demand for Treasury bills with maturities extending just beyond the year-end seemed to be elevated. The Manager noted that the recent path of purchases of agency debt was consistent with buying a cumulative amount of $175 billion by the end of the first quarter of 2010.

The staff briefed the Committee on recent developments regarding various Federal Reserve liquidity and credit facilities, including the Term Auction Facility (TAF), the primary credit program, the Term Asset-Backed Securities Loan Facility (TALF), and the swap lines with foreign central banks. Usage of these facilities had been declining in recent months as financial market conditions continued to improve. On September 24, the Board of Governors announced a gradual reduction in amounts to be auctioned under the TAF through January and indicated that auctions of credit with maturities longer than 28 days would be phased out. The staff reviewed the changes that had been made since the onset of the crisis to the terms of the primary credit program, including loan maturities and interest rates. The staff noted that reducing the maximum maturity of loans available under the primary credit program from 90 days to 28 days would represent another step toward normalization of the Federal Reserve's policy-implementation framework and would align the maximum maturities of the primary credit program with those under the TAF, but no action on this matter was taken by the Board at this meeting. Regarding the TALF, the staff indicated that auto and credit card asset-backed security issuance was increasingly being funded by non-TALF sources; however, commercial MBS remained more dependent on TALF financing.

The staff presented another update on the continuing development of several tools that could help support a smooth withdrawal of policy accommodation at the appropriate time. These measures include executing reverse repurchase agreements (RPs) on a large scale, potentially with counterparties other than the primary dealers; implementing a term deposit facility, available to depository institutions, to reduce the supply of reserve balances; and taking steps to tighten the link between the interest rate paid on reserve balances held at the Federal Reserve Banks and the federal funds rate. The staff had made considerable further progress on these tools. Participants expressed confidence that the Committee would be in a position to remove policy accommodation when appropriate by raising the rate of interest paid on excess reserves and by employing reserve-management tools such as reverse RPs, term deposits, and, if desirable, asset sales. Completing the operational work necessary to establish reverse RPs and term deposits as tools that can drain large volumes of reserves was viewed as an important near-term objective. Participants anticipated that the Federal Reserve would conduct tests of these tools, but they stressed that such testing would not imply that these tools would be employed for policy purposes any time soon.

Participants expressed a range of views about how the Committee might use its various tools in combination to foster most effectively its dual objectives of maximum employment and price stability. As part of the Committee's strategy for eventual exit from the period of extraordinary policy accommodation, several participants thought that asset sales could be a useful tool to reduce the size of the Federal Reserve's balance sheet and lower the level of reserve balances, either prior to or concurrently with increasing the policy rate. In their view, such sales would help reinforce the effectiveness of paying interest on excess reserves as an instrument for firming policy at the appropriate time and would help quicken the restoration of a balance sheet composition in which Treasury securities were the predominant asset. Other participants had reservations about asset sales—especially in advance of a decision to raise policy interest rates—and noted that such sales might elicit sharp increases in longer-term interest rates that could undermine attainment of the Committee's goals. Furthermore, they believed that other reserve management tools such as reverse RPs and term deposits would likely be sufficient to implement an appropriate exit strategy and that assets could be allowed to run off over time, reflecting prepayments and the maturation of issues. Participants agreed to continue to evaluate various potential policy-implementation tools and the possible combinations and sequences in which they might be used. They also agreed that it would be important to develop communication approaches for clearly explaining to the public the use of these tools and the Committee's exit strategy more broadly.

Staff Review of the Economic Situation

The information reviewed at the November 3–4 meeting suggested that overall economic activity continued to rise in recent months. Manufacturers increased production in September for the third consecutive month. The gradual recovery in construction of single-family homes from its extremely low level earlier in the year continued, and home sales increased in the third quarter. Although consumer spending on motor vehicles declined in September after the expiration of government rebates, other household spending rose. Outlays for equipment and software (E&S) appeared to be stabilizing. However, the labor market weakened further, and business spending on nonresidential structures continued to decline. Meanwhile, consumer price inflation remained subdued in recent months.

The labor market continued to weaken in September, but the pace of deterioration lessened from that seen earlier in the year. Job losses remained widespread across industries. The length of the average workweek for production and nonsupervisory workers decreased, and the index of aggregate hours worked for this group fell, albeit more slowly than earlier in the year. In the household survey, the unemployment rate rose in September to 9.8 percent, and the labor force participation rate fell to its lowest level of the year. Continuing claims for unemployment insurance through regular state programs declined through early October, but total claims, including those for extended and emergency benefits, remained high.

Industrial production rose in September for the third consecutive month. A substantial portion of the third-quarter gain was directly attributable to a rebound in motor vehicle assemblies and related parts production, but increases in production were widespread across the industrial sector. Indicators from business surveys suggested that there would be further gains in factory output over the near term. Nevertheless, considerable slack remained in the manufacturing sector, as the factory utilization rate for September was up only a bit from its historical low earlier this year.

For the third quarter as a whole, real personal consumption expenditures (PCE) rose at a solid rate, with noticeable increases in motor vehicles, furniture, electronics, and other durable goods. However, real outlays declined in September after a sharp increase in August. The monthly pattern in expenditures was significantly affected by swings in motor vehicle sales during and after the government's "cash-for-clunkers" program. Real disposable personal income fell for the fourth consecutive month in September, reflecting the weakness in the labor market. Poor labor market conditions and prior declines in household net worth appeared to have weighed on consumer sentiment, and the October Senior Loan Officer Opinion Survey on Bank Lending Practices (SLOOS) suggested that many banking institutions continued to tighten standards for consumer lending in the third quarter.

The housing sector continued to recover, on balance. Although single-family starts were about flat in September, the number of starts was well above the record low reached in the first quarter of the year. In the much smaller multifamily sector, where tight credit conditions persisted and vacancies remained elevated, starts were about unchanged. Sales of new homes, although down a bit in September, rose over the third quarter as a whole. The inventory of unsold new homes declined further, as sales outpaced construction. Sales of existing single-family homes increased in September and for the quarter as a whole, and recent resale activity appeared to be driven primarily by transactions of nondistressed properties. The average interest rate on 30-year conforming fixed-rate mortgages remained very low over the intermeeting period. Although some house price indexes had risen in recent months, such indexes remained below year-earlier levels.

Real spending on E&S appeared to have stabilized in the third quarter. Real business outlays on high-tech E&S increased modestly further, outlays for aircraft posted another gain, and business investment in motor vehicles and other areas was down only slightly. The improvements in a number of the fundamental determinants of investment in E&S, including a decline in the cost of capital and a rise in business output, suggested further, albeit sluggish, gains in spending over the next few quarters. The responses to the October SLOOS indicated that banks continued to tighten standards on commercial and industrial (C&I) loans to firms. Meanwhile, conditions in the nonresidential construction sector generally remained quite poor. The recent trend in architectural billings was consistent with further declines in nonresidential construction, and employment in the sector continued to decline. The October SLOOS suggested that financing for new construction projects was very difficult for businesses to obtain. The Bureau of Economic Analysis estimated that businesses continued to liquidate inventories in the third quarter, but at a slower rate than in the preceding quarter.

In August, the U.S. international trade deficit narrowed, as exports edged up and imports declined, but it remained wider than it had been at its recent low point in May. The increase in exports of goods and services was held down by a sharp drop in the volatile aircraft category. The decline in imports of goods and services was led by a lower volume of imported oil. In contrast, imports of machinery, automotive products, and industrial supplies increased.

Indicators of economic activity in the advanced foreign economies during the third quarter were mixed, but consistent with economic recovery in the aggregate. In most countries, purchasing managers surveys were at levels consistent with expansion, and many indicators of consumer and business confidence continued to show improvement. Economic indicators were strongest in Japan and the euro area, where industrial production rebounded sharply. In contrast, real gross domestic product (GDP) contracted in the United Kingdom in the third quarter, and real GDP in Canada edged down in July and August. In most emerging market economies, recent data showed that economic recovery continued in the third quarter. Real GDP increased strongly in China, Korea, and Singapore, and the recovery in Brazil continued. In Mexico, available data suggested that activity had begun to expand after several quarters of contraction. Across most of the major foreign economies, price pressures remained subdued. Twelve-month inflation remained elevated but declined further in Mexico and Brazil.

In the United States, recent monthly data indicated that consumer price inflation remained subdued. The PCE price index moved up only a bit in September as increases in energy prices were largely offset by declines in food prices. Core PCE prices also edged up during the month. Gasoline prices rose again in October. Median year-ahead inflation expectations in the final October Reuters/University of Michigan Surveys of Consumers increased, remaining higher than at the turn of the year, but longer-term inflation expectations from this survey were about unchanged. Measures of labor compensation rose moderately in the third quarter after decelerating significantly in the first half of the year. The employment cost index for wages and salaries was boosted by increases in several industry categories that might have been affected by the rise in the minimum wage in July. Output per hour rose sharply in the second and third quarters, contributing to a sizable decline in unit labor costs so far this year.

Staff Review of the Financial Situation

Market participants largely anticipated the decisions by the Federal Open Market Committee (FOMC) at the September meeting to leave the target range for the federal funds rate unchanged and to extend the Federal Reserve's purchases of agency MBS and agency debt through the end of the first quarter of 2010 to allow for a gradual reduction in the pace of these purchases. The announcement of the Committee's intent to purchase the full $1.25 trillion of agency MBS securities reduced some uncertainty about the cumulative amount of these purchases. After the release of the statement, investors marked down their expected path for the federal funds rate slightly; over subsequent weeks, that initial reaction was largely reversed so that, on balance, the expected path appeared to change little over the intermeeting period. Yields on nominal Treasury securities were about unchanged on net. Inflation compensation based on five-year Treasury inflation-protected securities (TIPS) rose over the intermeeting period, apparently owing in part to an increase in oil and other commodity prices, while five-year inflation compensation five years ahead was little changed.

Overall conditions in short-term funding markets eased a bit further during the intermeeting period. Spreads between London interbank offered rates (Libor) and overnight index swap (OIS) rates at the one- and three-month maturities were about unchanged and were near their pre-crisis levels. Spreads at the six-month maturity narrowed but remained elevated. Spreads on A2/P2-rated commercial paper (CP) and AA-rated asset-backed CP remained at the lower ends of their respective ranges over the past two years. Indicators of Treasury market functioning, including on-the-run liquidity premiums for the 10-year Treasury note and trading volumes in both the nominal and TIPS markets, showed some signs of improvement over the intermeeting period, but trading conditions remained somewhat impaired. Year-end pressures in funding markets generally appeared modest. However, some evidence pointed to increased demand for Treasury securities that mature soon after the turn of the year.

Broad stock price indexes were about unchanged, on net, over the intermeeting period despite initial third-quarter earnings reports that mostly beat analysts' forecasts. Option-implied volatility on the S&P 500 index moved up slightly. The spread between an estimate of the expected real return on equity over the next 10 years for S&P 500 firms and an estimate of the real 10-year Treasury yield—a rough gauge of the equity risk premium—remained elevated. Corporate bond spreads narrowed further as yields on investment- and speculative-grade corporate bonds decreased more than those on comparable-maturity Treasury securities. Bid-asked spreads for corporate bonds—a measure of liquidity in this market—remained at moderate levels. Conditions in the secondary market for leveraged syndicated loans continued to improve, as secondary-market prices rose and bid-asked spreads narrowed.

Investor sentiment toward the banking sector appeared to deteriorate over the intermeeting period. Bank share prices fell, with equity prices for large banks declining more than those for regional and smaller banks. Credit default swap spreads for large bank holding companies were about flat, but they widened for regional and smaller banking organizations. Market participants reportedly remained concerned about the earnings prospects for banks in an environment of weak economic activity and rising loan losses.

Debt of the private domestic nonfinancial sector appeared to have declined again in the third quarter, as estimates suggested that household debt edged down and nonfinancial business debt decreased. Consumer credit contracted for the seventh consecutive month in August, reflecting declines in both revolving and nonrevolving credit; issuance of consumer credit asset-backed securities also fell. Gross issuance of bonds by investment-grade nonfinancial corporations slowed somewhat in October, even as speculative-grade firms continued to issue bonds at a robust pace. CP outstanding increased, though gains were concentrated at a few large issuers. Bank loans continued to contract rapidly. In contrast, the federal government continued to issue debt at a brisk pace, and gross issuance of state and local government debt remained strong in October.

Bank credit declined in September and in the first half of October, as the contraction in C&I loans contributed importantly to a further decline in total loans over the period. According to the SLOOS, bank lending standards and terms tightened further and demand continued to decline, on net, for most types of loans in the third quarter. Commercial real estate (CRE) loans also continued to decrease, reportedly because of widespread paydowns and charge-offs. In addition, residential mortgage loans on banks' books fell, and revolving home equity loans and consumer loans also contracted. The pace of decline in total loans at large banks continued to exceed that at smaller banks. The allowance for loan and lease losses rose further at large banks in September, but it was about unchanged at small banks.

M2 appeared to have expanded at a moderate rate in September and October. While liquid deposits rose rapidly, small time deposits and retail money market mutual funds continued to contract. Meanwhile, currency increased amid moderate demand for U.S. currency from abroad.

Stock indexes fell over the intermeeting period in most major industrial economies, while 10-year sovereign yields declined in Europe and were little changed in Japan and Canada. Equity prices were mixed in emerging markets, and credit spreads on emerging market sovereign debt edged up. The trade-weighted index of the foreign exchange value of the dollar was little changed over the intermeeting period. The Reserve Bank of Australia and Norges Bank raised their policy rates, while most other central banks left their respective policy rates unchanged over the intermeeting period. The European Central Bank, the Bank of England, and the Bank of Japan continued implementing their special liquidity and asset purchase programs, although Bank of Japan officials indicated they would let some credit-easing programs expire at the end of the year.

Staff Economic Outlook

In the forecast prepared for the November FOMC meeting, the staff raised its projection for real GDP growth over the second half of 2009 but left the forecast for output growth in 2010 and 2011 roughly unchanged. The spending and production data received during the intermeeting period suggested that economic activity, especially household spending, was a little stronger in the summer than previously estimated. Also, industrial production increased more than had been anticipated at the September meeting. But with labor market conditions somewhat weaker than anticipated, earlier declines in wealth still weighing on household balance sheets, and measures of consumer sentiment relatively low, the staff did not take much signal from the recent unexpected strength in spending and output. Indeed, the staff boosted its projection for the unemployment rate over the next several years. Still, the staff continued to believe that several factors that were restraining spending would gradually fade. The staff anticipated that the strengthening of the recovery in real output during 2010 and 2011 would be supported by an ongoing improvement in financial conditions and household balance sheets, continued recovery in the housing sector, improved household and business confidence, and accommodative monetary policy even as the impetus to real activity from fiscal policy diminished.

The staff forecast for inflation was little changed from the September meeting. Although oil prices moved higher, likely boosting near-term inflation, the staff also revised up its estimate of the degree of slack in the economy, leaving the forecast for total and core PCE inflation over the next two years little changed. With significant underutilization of resources expected to persist for several years, the staff continued to project that core inflation would slow somewhat further over the next two years.

Participants' Views on Current Conditions and the Economic Outlook

In conjunction with this FOMC meeting, all meeting participants—the five members of the Board of Governors and the presidents of the 12 Federal Reserve Banks—provided projections for economic growth, the unemployment rate, and consumer price inflation for each year from 2009 through 2012 and over a longer horizon. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks. Participants' forecasts through 2012 and over the longer run are described in the Summary of Economic Projections, which is attached as an addendum to these minutes.

In the meeting participants' discussion of the economic situation and outlook, they agreed that the incoming data and information received from business contacts suggested that economic activity was picking up as anticipated, with output continuing to expand in the fourth quarter. A number of factors were expected to support near-term growth: Business inventories were being brought into better alignment with sales, and the pace of inventory runoff was slowing; activity in the housing sector appeared to be turning up, and house prices seemed to be leveling out or beginning to rise by some measures; consumer spending appeared to be rising even apart from the effects of fiscal incentives to purchase autos; the outlook for growth abroad had improved since earlier in the year, auguring well for U.S. exports; and U.S. and global financial market conditions, while roughly unchanged over the intermeeting period, were substantially better than earlier in the year. Above-trend output growth in the third quarter was a welcome development. Moreover, the upturn in real GDP appeared to reflect stronger final demand and not just a slower pace of inventory decumulation. While these developments were positive, participants noted that it was not clear how much of the recent firming in final demand reflected the effects of temporary fiscal programs to support the auto and housing sectors, and some participants expressed concerns about the ability of the economy to generate a self-sustaining recovery without government support. Nonetheless, participants expected the recovery to continue in subsequent quarters, although at a pace that would be rather slow relative to historical experience, particularly the robust recoveries that followed previous steep downturns. Such a modest pace of expansion would imply only slow improvement in the labor market next year, with unemployment remaining high. Indeed, participants noted that business contacts continued to report plans to be cautious in hiring and capital spending even as demand for their products increased. Nonetheless, economic growth was expected to strengthen during the next two years as housing construction continued to rise and financial conditions improved further, leading to more-substantial increases in resource utilization in product and labor markets.

Most participants now viewed the risks to their growth forecasts as being roughly balanced rather than tilted to the downside, but uncertainty surrounding these forecasts was still viewed as quite elevated. Downside risks to growth included the continued weakness in the labor market and its implications for income growth and consumer confidence, as well as the potential for credit availability to remain relatively tight for consumers and some businesses. In this regard, some participants noted the difficulty that smaller, bank-dependent firms were having in securing financing. The CRE sector was also considered a downside risk to the forecast and a possible source of increased pressure on banks. On the other hand, consumer spending on items other than autos had been stronger than expected, which might be signaling more underlying momentum in the recovery and some chance that the step-up in spending would be sustained going forward. In addition, growth abroad had exceeded expectations for some time, potentially providing more support to U.S. exports and domestic growth than anticipated.

Financial market developments over recent months were generally regarded as supportive of continued economic recovery, with equity prices considerably higher, private credit spreads substantially lower, and financial markets generally performing significantly better than earlier in the year. Participants noted, however, that bank credit remained tight. With rising levels of nonperforming loans expected to continue to be a source of stress, and with many regional and small banks vulnerable to the deteriorating performance of CRE loans, banks continued to tighten lending standards for C&I loans and consumer loans, although the net percentage of banks reporting further tightening in each category had fallen in recent surveys. Bank loans continued to contract sharply in all categories. Participants noted that the dichotomy between significant easing of conditions in capital markets and continuing tight conditions in the banking sector implied that financing conditions differed for large and small firms. Large firms with access to debt and equity markets for financing had relatively little difficulty in obtaining credit and in many cases also had high levels of retained earnings with which to fund their operations and investment. In contrast, smaller firms, which tend to be more dependent on commercial banks for financing, reportedly faced substantial constraints in their access to credit. Limited credit availability, along with weak aggregate demand, was viewed as likely to restrain hiring at small businesses, which are normally a source of employment growth in recoveries.

The weakness in labor market conditions remained an important concern to meeting participants, with unemployment expected to remain elevated for some time. Although the pace of job losses was moderating, the unusually large fraction of those who were working part time for economic reasons and the unusually low level of the average workweek pointed to only a gradual decline in the unemployment rate as the economic recovery proceeded. In addition, business contacts reported that they would be cautious in their hiring and would continue to aggressively seek cost savings in the absence of revenue growth. Indeed, participants expected that businesses would be able to meet any increases in demand in the near term by raising their employees' hours and boosting productivity, thus delaying the need to add to their payrolls; this view was supported by aggregate data indicating rapid productivity growth in recent quarters. Moreover, the need to reallocate labor across sectors as the recovery proceeds, as well as losses of skills caused by high levels of long-term unemployment and permanent separations, could limit the pace of gains in employment. Participants discussed the possibility that this recovery could resemble the past two, which were characterized by a slow pace of hiring for a time even after aggregate demand picked up.

The prospect for continued weakness in labor markets remained an important factor in the outlook for consumer spending. Although consumer spending had picked up more than expected in recent months, participants saw that increase as partly reflecting special factors such as the cash-for-clunkers program. Uncertain job prospects, slow income growth, and tight credit, as well as wealth levels that remained relatively low despite the recent rise in equity prices and stabilization in house prices, were seen as weighing on consumer confidence and the growth of consumer spending for some time to come. In such an environment, households' saving behavior was an important source of uncertainty in the outlook. Participants continued to believe that the most likely outcome was for the saving rate to remain near its average level over the past few quarters or to edge up gradually. However, they could not completely discount the possibility of a further substantial rise in the saving rate as households took further steps to repair their balance sheets.

Participants noted that firms seemed to be reducing inventories at a slower pace than earlier in the year and apparently had made substantial progress in reducing stocks toward desired levels. With inventories lower, firms were beginning to raise production to meet at least a portion of increased demand, and this adjustment was expected to make an important contribution to economic recovery in the fourth quarter of the year and, to a lesser extent, in 2010 as well. Investment in E&S appeared to have stabilized in the third quarter, and recent data on new orders continued to point to a pickup next year. However, many participants expressed the view that cautious business sentiment, together with low industrial utilization rates, was likely to keep new capital spending subdued until firms became more confident about the durability of increases in demand.

In the residential real estate sector, home sales and construction increased over recent months from very low levels; moreover, house prices appeared to be stabilizing and in some areas had reportedly moved higher. Generally, the outlook was for these trends to continue. However, some participants still viewed the improvements as quite tentative, pointing to potential sources of softness from the pending termination of the temporary tax credit for first-time homebuyers, the winding down of the Federal Reserve's agency MBS purchase program, and the downward pressure that anticipated further increases in foreclosures would put on house prices. In contrast to developments in the residential sector, CRE activity continued to fall markedly in most Districts as a result of deteriorating fundamentals, including declining occupancy and rental rates and very tight credit conditions.

Stronger foreign economic activity, especially in Asia, as well as the partial reversal this year of the dollar's appreciation during the latter part of 2008, was providing support to U.S. exports. Participants noted that the recent fall in the foreign exchange value of the dollar had been orderly and appeared to reflect an unwinding of safe-haven demand in light of the recovery in financial market conditions this year, but that any tendency for dollar depreciation to intensify or to put significant upward pressure on inflation would bear close watching. Further improvements in foreign economies would likely buoy U.S. exports going forward, but as the recovery took hold in the United States, import growth would also strengthen.

Participants continued to discuss the appropriate weights to place on resource slack, inflation expectations, and other factors in assessing the inflation outlook. In the near term, most participants anticipated that substantial slack in both labor and product markets would likely keep inflation subdued. Indeed, the considerable decelerations in wages and unit labor costs this year were cited as factors putting downward pressure on inflation. However, some participants noted that the recent rise in the prices of oil and other commodities, as well as increases in import prices stemming from the decline in the foreign exchange value of the dollar, could boost inflation pressures. Overall, many participants viewed the risks to their inflation outlooks over the next few quarters as being roughly balanced. Some saw the risks as tilted to the downside in the near term, reflecting the quite elevated level of economic slack and the possibility that inflation expectations could begin to decline in response to the low level of actual inflation. But others felt that risks were tilted to the upside over a longer horizon, because of the possibility that inflation expectations could rise as a result of the public's concerns about extraordinary monetary policy stimulus and large federal budget deficits. Moreover, these participants noted that banks might seek to reduce appreciably their excess reserves as the economy improves by purchasing securities or by easing credit standards and expanding their lending substantially. Such a development, if not offset by Federal Reserve actions, could give additional impetus to spending and, potentially, to actual and expected inflation. To keep inflation expectations anchored, all participants agreed that it was important for policy to be responsive to changes in the economic outlook and for the Federal Reserve to continue to clearly communicate its ability and intent to begin withdrawing monetary policy accommodation at the appropriate time and pace.

Committee Policy Action

In the members' discussion of monetary policy for the period ahead, they agreed that no substantive changes to the Committee's federal funds target range or large-scale asset purchase programs were warranted at this meeting. On balance, the economic outlook had changed little since the September meeting. The recovery appeared to be continuing and was expected to gradually strengthen over time. Still, most members projected that over the next couple of years, the unemployment rate would remain quite elevated and the level of inflation would remain below rates consistent over the longer run with the Federal Reserve's objectives. Based on this outlook, members decided to maintain the federal funds target range at 0 to ¼ percent and to continue to state their expectation that economic conditions were likely to warrant exceptionally low rates for an extended period. Low levels of resource utilization, subdued inflation trends, and stable inflation expectations were among the important factors underlying their expectation for monetary policy, and members agreed that policy communications would be enhanced by citing these conditions in the policy statement. Members noted the possibility that some negative side effects might result from the maintenance of very low short-term interest rates for an extended period, including the possibility that such a policy stance could lead to excessive risk-taking in financial markets or an unanchoring of inflation expectations. While members currently saw the likelihood of such effects as relatively low, they would remain alert to these risks. All agreed that the path of short-term rates going forward would be dependent on the evolution of the economic outlook.

With respect to the large-scale asset purchase programs, all members supported reiterating the Committee's intention to purchase $1.25 trillion of agency MBS by the end of the first quarter of 2010. The Committee also agreed to specify that its agency debt purchases would cumulate to about $175 billion by the end of the first quarter, $25 billion less than the previously announced maximum for these purchases. Owing to the limited availability of agency debt and concerns that larger purchases could impair market functioning, the Committee's transactions in these instruments for some time had been on a trajectory that would leave total purchases somewhat below the previously established maximum. Announcing that purchases would total about $175 billion was viewed as providing greater clarity to the public regarding the expected amount of purchases and would not reflect a decision to scale back the degree of policy accommodation. Members also decided to reiterate their intention to gradually slow the pace of the Committee's agency MBS and agency debt purchases to promote a smooth transition in markets as the announced purchases are completed. The Committee agreed that it would continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

> "The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase agency debt and agency MBS during the intermeeting period with the aim of providing support to private credit markets and economic activity. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of private credit market conditions. The Desk is expected to execute purchases of about $175 billion in housing-related agency debt and about $1.25 trillion of agency MBS by the end of the first quarter of 2010. The Desk is expected to gradually slow the pace of these purchases as they near completion. The Committee anticipates that outright purchases of securities will cause the size of the Federal Reserve's balance sheet to expand significantly in coming months. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in September suggests that economic activity has continued to pick up. Conditions in financial markets were roughly unchanged, on balance, over the intermeeting period. Activity in the housing sector has increased over recent months. Household spending appears to be expanding but remains constrained by ongoing job losses, sluggish income growth, lower housing wealth, and tight credit. Businesses are still cutting back on fixed investment and staffing, though at a slower pace; they continue to make progress in bringing inventory stocks into better alignment with sales. Although economic activity is likely to remain weak for a time, the Committee anticipates that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will support a strengthening of economic growth and a gradual return to higher levels of resource utilization in a context of price stability.

With substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.

In these circumstances, the Federal Reserve will continue to employ a wide range of tools to promote economic recovery and to preserve price stability. The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve will purchase a total of $1.25 trillion of agency mortgage-backed securities and about $175 billion of agency debt. The amount of agency debt purchases, while somewhat less than the previously announced maximum of $200 billion, is consistent with the recent path of purchases and reflects the limited availability of agency debt. In order to promote a smooth transition in markets, the Committee will gradually slow the pace of its purchases of both agency debt and agency mortgage-backed securities and anticipates that these transactions will be executed by the end of the first quarter of 2010. The Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. The Federal Reserve is monitoring the size and composition of its balance sheet and will make adjustments to its credit and liquidity programs as warranted."

> Voting for this action: Messrs. Bernanke and Dudley, Ms. Duke, Messrs. Evans, Kohn, Lacker, Lockhart, Tarullo, and Warsh, and Ms. Yellen.
>
> Voting against this action: None.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, December 15–16, 2009. The meeting adjourned at 12:40 p.m. on November 4, 2009.

Notation Vote

By notation vote completed on October 13, 2009, the Committee unanimously approved the minutes of the FOMC meeting held on September 22–23, 2009.

Brian F. Madigan
Secretary

Addendum: Summary of Economic Projections

In conjunction with the November 3–4, 2009, FOMC meeting, the members of the Board of Governors and the presidents of the Federal Reserve Banks, all of whom participate in deliberations of the FOMC, submitted projections for output growth, unemployment, and inflation for the years 2009 to 2012 and over the longer run. The projections were based on information available through the end of the meeting and on

Table 1. Economic projections of Federal Reserve Governors and Reserve Bank presidents, November 2009

Percent

Variable	Central tendency[1]					Range[2]				
	2009	2010	2011	2012	Longer Run	2009	2010	2011	2012	Longer Run
Change in real GDP	–0.4 to –0.1	2.5 to 3.5	3.4 to 4.5	3.5 to 4.8	2.5 to 2.8	–0.5 to 0.0	2.0 to 4.0	2.5 to 4.6	2.8 to 5.0	2.4 to 3.0
June projection	–1.5 to –1.0	2.1 to 3.3	3.8 to 4.6	n.a.	2.5 to 2.7	–1.6 to –0.6	0.8 to 4.0	2.3 to 5.0	n.a.	2.4 to 2.8
Unemployment rate	9.9 to 10.1	9.3 to 9.7	8.2 to 8.6	6.8 to 7.5	5.0 to 5.2	9.8 to 10.3	8.6 to 10.2	7.2 to 8.7	6.1 to 7.6	4.8 to 6.3
June projection	9.8 to 10.1	9.5 to 9.8	8.4 to 8.8	n.a.	4.8 to 5.0	9.7 to 10.5	8.5 to 10.6	6.8 to 9.2	n.a.	4.5 to 6.0
PCE inflation	1.1 to 1.2	1.3 to 1.6	1.0 to 1.9	1.2 to 1.9	1.7 to 2.0	1.0 to 1.7	1.1 to 2.0	0.6 to 2.4	0.2 to 2.3	1.5 to 2.0
June projection	1.0 to 1.4	1.2 to 1.8	1.1 to 2.0	n.a.	1.7 to 2.0	1.0 to 1.8	0.9 to 2.0	0.5 to 2.5	n.a.	1.5 to 2.1
Core PCE inflation[3]	1.4 to 1.5	1.0 to 1.5	1.0 to 1.6	1.0 to 1.7		1.3 to 1.6	0.9 to 2.0	0.5 to 2.4	0.2 to 2.3	
June projection	1.3 to 1.6	1.0 to 1.5	0.9 to 1.7	n.a.		1.2 to 2.0	0.5 to 2.0	0.2 to 2.5	n.a.	

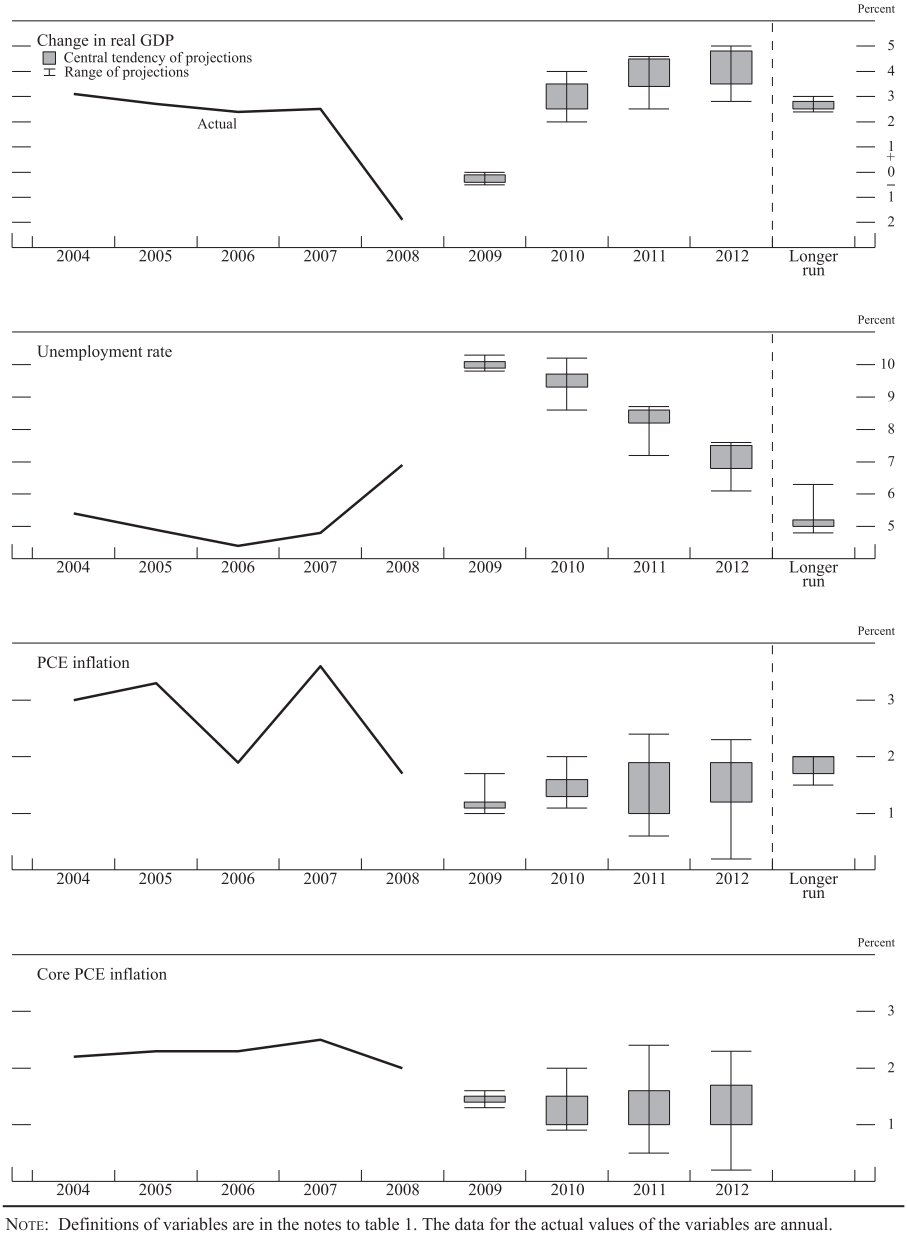
NOTE: Projections of change in real gross domestic product (GDP) and in inflation are from the fourth quarter of the previous year to the fourth quarter of the year indicated. PCE inflation and core PCE inflation are the percentage rates of change in, respectively, the price index for personal consumption expenditures (PCE) and the price index for PCE excluding food and energy. Projections for the unemployment rate are for the average civilian unemployment rate in the fourth quarter of the year indicated. Each participant's projections are based on his or her assessment of appropriate monetary policy. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge under appropriate monetary policy and in the absence of further shocks to the economy. The June projections were made in conjunction with the meeting of the Federal Open Market Committee on June 23–24, 2009.

1. The central tendency excludes the three highest and three lowest projections for each variable in each year.
2. The range for a variable in a given year consists of all participants' projections, from lowest to highest, for that variable in that year.
3. Longer-run projections for core PCE inflation are not collected.

each participant's assumptions about factors likely to affect economic outcomes, including his or her assessment of appropriate monetary policy. "Appropriate monetary policy" is defined as the future path of policy that the participant deems most likely to foster outcomes for economic activity and inflation that best satisfy his or her interpretation of the Federal Reserve's dual objectives of maximum employment and stable prices. Longer-run projections represent each participant's assessment of the rate to which each variable would be expected to converge over time under appropriate monetary policy and in the absence of further shocks.

As depicted in Figure 1, FOMC participants anticipated that economic recovery would be gradual, with real gross domestic product (GDP) growing at a moderate pace and the unemployment rate declining slowly over the next few years. Most participants also expected that inflation would remain subdued over this period. As indicated in Table 1, participants marked up their projections for real GDP growth in 2009, reflecting a faster pickup in output during the second half of the year than they had anticipated at the time of their previous forecasts, which were made in conjunction with the June FOMC meeting. Looking beyond 2009, the contours of the participants' outlook for economic activity and inflation were broadly similar to those in their June projections, with the pace of the economic recovery expected to be restrained by household and business uncertainty, weak labor market conditions, and slow waning of tight credit conditions in the banking system. Most participants anticipated that about five or six years would be needed for the economy to converge fully to a longer-run path characterized by a sustainable rate of output growth and by rates of unemployment and inflation consistent

Figure 1. Central tendencies and ranges of economic projections, 2009–12 and over the longer run



NOTE: Definitions of variables are in the notes to table 1. The data for the actual values of the variables are annual.

with their interpretation of the Federal Reserve's objectives. However, some participants indicated that the convergence process might well require even longer, while a few expected that although inflation would settle at its longer-run rate in the next several years, the convergence process for the real economy was likely to occur over a somewhat longer period. With a further waning of downside risks to growth since June, nearly all participants now judged the risks to their growth outlook as roughly balanced, and most also saw roughly balanced risks surrounding their inflation projections. As in June, however, participants generally judged that their projections for economic activity and inflation were subject to an unusually high degree of uncertainty relative to historical norms.

The Outlook

Participants' projections for real GDP growth in 2009 had a central tendency of negative 0.4 percent to negative 0.1 percent, around a percentage point above the central tendency of their June projections. The projections for the year as a whole were broadly consistent with participants' previous expectations that economic activity would bottom out around midyear. However, the contraction over the first half was a bit sharper than many participants had anticipated at the time of the June FOMC meeting, which took place about a month before the Bureau of Economic Analysis (BEA) published its advance estimate of second-quarter GDP and its comprehensive revision of previous estimates, including a substantial downward revision to the estimate of first-quarter GDP growth. Subsequent data on consumer spending, housing starts, and industrial production, as well as the advance estimate of third-quarter GDP, suggested that the economy was growing at a moderate pace over the second half of the year. Participants took note of the continuing improvement in financial market conditions, the progress that businesses appeared to be making in bringing inventories into line with sales, and the signs of stronger growth abroad, especially in Asia. Participants also indicated that GDP growth in the second half of 2009 had likely been boosted by transitory factors such as the "cash-for-clunkers" program and the first-time homebuyers' credit, which had brought forward spending that would have otherwise occurred in subsequent quarters.

Looking beyond this year, participants' outlook for real GDP growth was generally similar to that reflected in their June forecasts. The central tendency of their output growth projections was 2.5 to 3.5 percent for 2010, 3.4 to 4.5 percent for 2011, and 3.5 to 4.8 percent for 2012. Participants indicated that consumer spending would likely be bolstered by the turnaround in housing prices, further increases in equity values, and gradual improvements in credit availability. With an improved sales outlook, businesses would rebuild their inventory stocks and spending on equipment and software would pick up; in addition, exports would likely receive a significant boost from stronger global growth. Monetary and fiscal stimulus would provide further support to aggregate demand next year. Nevertheless, the pace of expansion would probably be damped for some time by elevated uncertainty on the part of households and businesses and by the slow and lagging recovery of labor markets, which would hold down income growth and limit any rebound in household confidence. In addition, distress in commercial real estate markets would likely weigh further on the balance sheets of banking institutions, thereby contributing to continued tight credit conditions for many households and smaller firms. However, participants anticipated that the recovery would gather steam in 2011 and 2012 as a consequence of further improvements in consumer and business confidence and in the condition of financial markets and institutions. In the absence of any further shocks, participants generally expected that the economy would converge over time to a sustainable path with real GDP growing at a rate of 2.5 to 2.8 percent, reflecting longer-term demographic trends and improvements in labor productivity.

Participants generally anticipated that the unemployment rate would rise somewhat further during the final months of 2009 and then decline steadily over the next few years. Their projections for the average unemployment rate in the fourth quarter of 2009 had a central tendency of 9.9 to 10.1 percent, somewhat higher than the actual unemployment rate of 9.8 percent in September—the latest reading available at the time of the November FOMC meeting. Participants noted that, as in the early stages of previous recoveries the unemployment rate was continuing to rise after output turned up, reflecting firms' uncertainty about the pace of recovery and their efforts to raise productivity and hold down costs. Looking further ahead, participants' unemployment rate projections had a central tendency of 9.3 to 9.7 percent for the fourth quarter of 2010, 8.2 to 8.6 percent for the end of 2011, and 6.8 to 7.5 percent for the final quarter of 2012. A number of participants made modest upward revisions to their estimates of the longer-run sustainable rate of unemployment in light of their assessments of the extent to which ongoing structural adjustments would be associated with somewhat higher labor market frictions. Thus, participants' longer-run unemployment rate projections had a central tendency of 5.0 to 5.2 percent, about a quarter percentage point higher than in June.

The central tendency of participants' projections for personal consumption expenditures (PCE) inflation in 2009 was 1.1 to 1.2 percent, and the central tendency of their projections for core PCE inflation was 1.4 to 1.5 percent.[16] While actual PCE inflation over the first half of the year turned out to be somewhat lower than participants had anticipated at the time of the June FOMC meeting, recent increases in energy prices led most of them to make upward revisions to their second-half inflation forecasts; thus, participants' PCE inflation projections for the year as a whole were broadly similar to their previous forecasts. Core PCE inflation was 1.6 percent at an annual rate over the first half of 2009, about a quarter point lower than most participants had anticipated last June, and nearly all participants projected that core PCE inflation would decline further to an annual rate of about 1¼ percent in the second half.

Looking beyond this year, participants generally anticipated that inflation would remain subdued. The central tendency of their projections for PCE inflation was 1.3 to 1.6 percent for 2010, 1.0 to 1.9 percent for 2011, and 1.2 to 1.9 percent for 2012, and the

16. In July 2009, the BEA adjusted the definition of core PCE inflation to include prices for food consumed at restaurants and other establishments away from home. FOMC participants indicated that this definitional adjustment did not cause any material changes in their core inflation projections for 2009 or beyond.

central tendency of their projections for core PCE inflation was 1.0 to 1.5 percent for 2010, 1.0 to 1.6 percent for 2011, and 1.0 to 1.7 percent for 2012. Many participants stated that well-anchored inflation expectations would play an important role in avoiding further declines in inflation over the next few years despite the persistence of sizable resource slack. Participants also pointed out that strong global growth was likely to place significant upward pressure on the prices of energy and other commodities; as a consequence, their projections for overall inflation over the next several years were generally a notch higher than their projections for core inflation. As in June, the central tendency of projections for PCE inflation over the longer run was 1.7 to 2.0 percent, reflecting participants' assessments of the measured rate of inflation that would best satisfy the Federal Reserve's dual mandate of maximum employment and stable prices. Most participants expected that inflation in 2012 would remain below its longer-run value, but a few expected inflation to have converged to its longer-run value by that time.

Uncertainty and Risks

As in June, nearly all participants judged the degree of uncertainty surrounding their projections of output growth and unemployment as higher than historical norms.[17] Participants generally saw the risks to these projections as roughly balanced, although a few indicated that the risks to the unemployment outlook remained weighted to the upside. In explaining these judgments, participants highlighted the intrinsic difficulties in predicting the dynamics of the economy following a financial crisis and a severe recession. Participants noted that the recent pickup in economic growth might reflect stronger underlying momentum in economic activity than anticipated and hence point to a faster pace of recovery going forward. On the other hand, participants referred to the possibility that deteriorating performance of commercial real estate and consumer loans could have adverse effects on the financial system that would damp the growth of output and employment over coming quarters.

Most participants continued to see the uncertainty surrounding their inflation projections as unusually high, although a few viewed the extent of

Table 2. Average historical projection error ranges
Percentage points

Variable	2009	2010	2011	2012
Change in real GDP[1] . . .	±0.6	±1.4	±1.6	±1.5
Unemployment rate[1]	±0.2	±0.7	±0.9	±1.1
Total consumer prices[2] . .	±0.5	±1.0	±1.0	±1.0

NOTE: Error ranges shown are measured as plus or minus the root mean squared error of projections for 1989 through 2008 that were released in the fall by various private and government forecasters. As described in the box "Forecast Uncertainty," under certain assumptions, there is about a 70 percent probability that actual outcomes for real GDP, unemployment, and consumer prices will be in ranges implied by the average size of projection errors made in the past. Further information is in David Reifschneider and Peter Tulip (2007), "Gauging the Uncertainty of the Economic Outlook from Historical Forecasting Errors," Finance and Economics Discussion Series 2007-60 (Washington: Board of Governors of the Federal Reserve System, November).

1. For definitions, refer to general note in table 1.

2. Measure is the overall consumer price index, the price measure that has been most widely used in government and private economic forecasts. Projection is percent change, fourth quarter of the previous year to the fourth quarter of the year indicated.

17. Table 2 provides estimates of forecast uncertainty for the change in real GDP, the unemployment rate, and total consumer price inflation over the period from 1989 to 2008. At the end of this summary, the box "Forecast Uncertainty" discusses the sources and interpretation of uncertainty in economic forecasts and explains the approach used to assess the uncertainty and risks attending participants' projections.

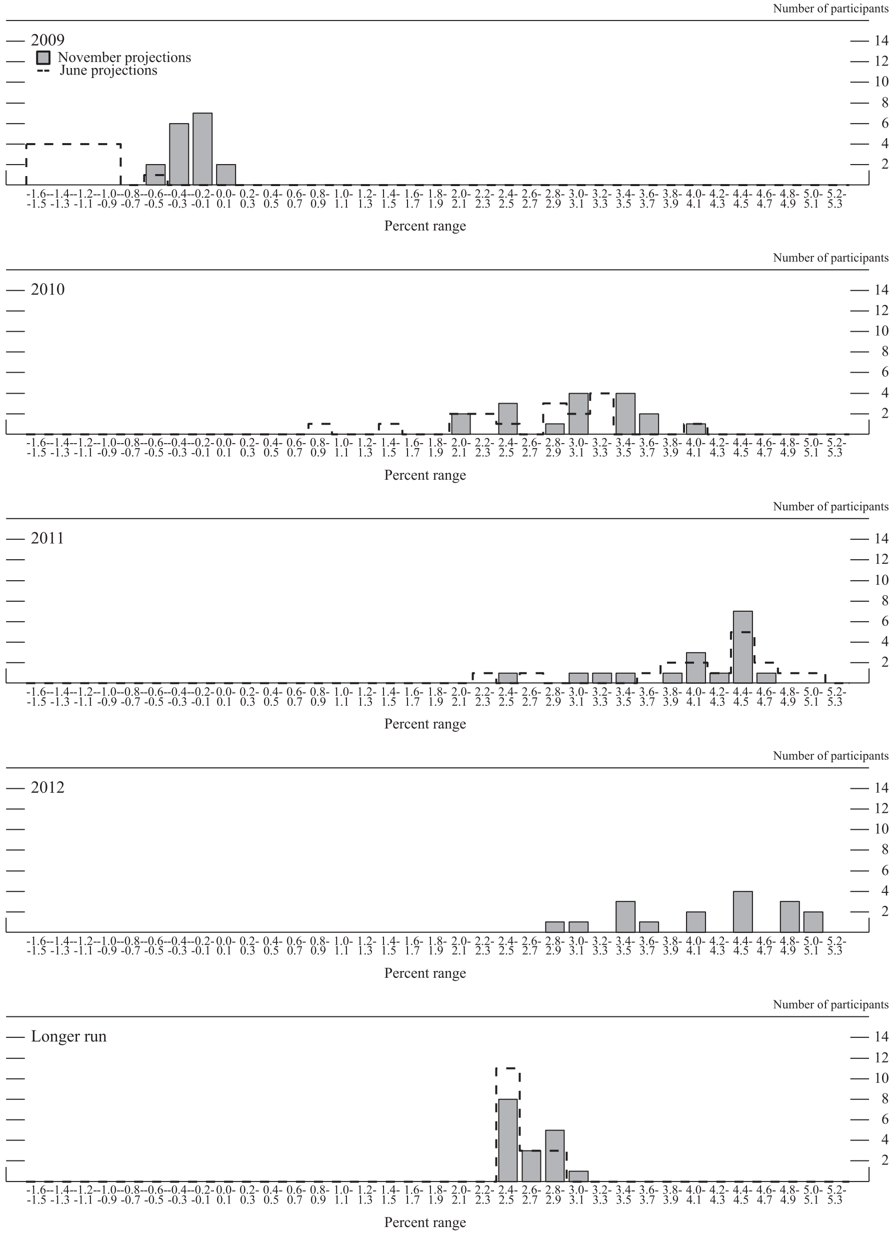
such uncertainty as roughly in line with historical norms. Participants generally judged the risks to the inflation outlook to be roughly balanced, and many of them indicated that these risks were linked, at least in part, to the risks associated with the economic outlook. Participants cited the risk that longer-term inflation expectations might start drifting downward in response to persistent economic slack and low inflation outcomes; alternatively, those expectations could shift upwards in response to a sharper recovery, especially if extraordinary monetary policy stimulus were not unwound in a timely fashion. Participants also noted the possibility that an acceleration in global economic activity could induce a surge in the prices of energy and other commodities that would place upward pressure on headline inflation.

Diversity of Views

Figures 2.A and 2.B provide further details on the diversity of participants' views regarding likely outcomes for real GDP growth and the unemployment rate in 2009, 2010, 2011, 2012, and over the longer run. The dispersion in these projections reflects, among other factors, differences in the participants' assessments regarding the current degree of underlying momentum in economic activity, the evolution of consumer and business sentiment, and the trajectory for private saving, and in their interpretations of the continued weakness in bank credit. The distribution of participants' GDP growth projections for 2009 shifted upward about a percentage point and became narrower in response to the economic and financial information received since the June FOMC meeting. Most participants only shaded up their growth projections for 2010, but a few participants made more substantial upward revisions; hence the lowest points in the distribution increased markedly while the median was just a notch higher than in June. The distribution of growth projections for 2011 was little changed from June, while the distribution for 2012 was centered at a slightly higher rate than for 2011 with about the same degree of dispersion. A few participants made modest upward revisions to their estimates of the longer-run sustainable rate of output growth, producing a slight widening of the range for these longer-run projections. Regarding participants' unemployment rate projections, the distribution for 2009 narrowed but with roughly the same mode as in June, while the distributions for 2010 and 2011 shifted down a bit and narrowed somewhat. The distribution of unemployment rate projections for 2012 exhibited noticeably greater dispersion than for 2011. The distribution of longer-run unemployment rate projections was generally more tightly concentrated than in June, reflecting modest upward revisions to some participants' estimates of the sustainable rate of unemployment to which the economy would converge under appropriate monetary policy and in the absence of further shocks.

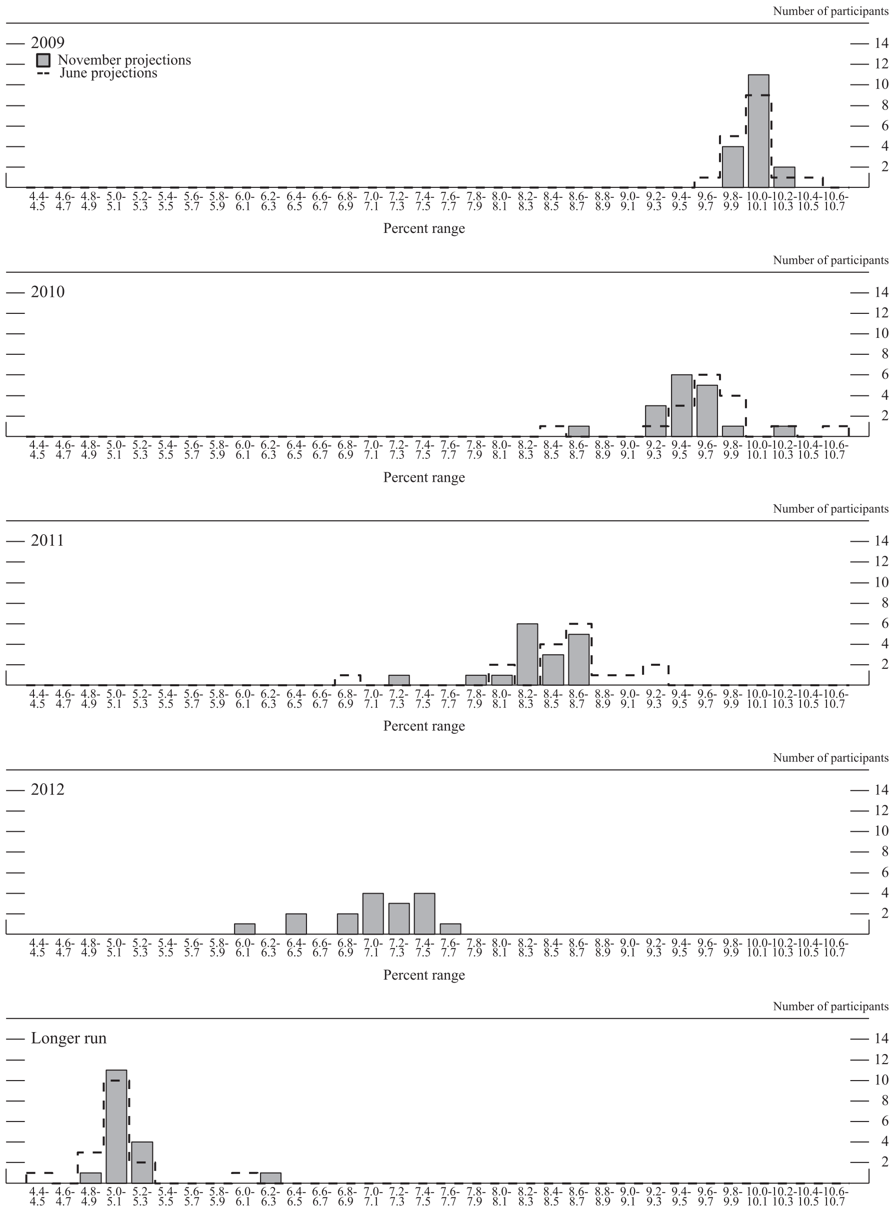
Figures 2.C and 2.D provide corresponding information about the diversity of participants' views regarding the inflation outlook. For total PCE inflation, the distribution of participants' projections for 2009 was narrower than in June, whereas the distributions of their projections for 2010 and 2011 did not change significantly, and there was virtually no change in the distribution of longer-run projections. For core PCE inflation, participants' projections for 2009 became more tightly concentrated, while their projections for 2010 and 2011 were only slightly less dispersed than in June. The distributions of total and core PCE inflation projections for 2012 exhibited somewhat greater dispersion than those for 2011. The dispersion in participants' projections for 2010, 2011, and 2012 mainly reflected differences in their judgments regarding the determinants of inflation, including their estimates of prevailing resource slack and their assessments of the extent to which that slack affects inflation outcomes and expectations. In contrast, the relatively concentrated distribution of longer-run inflation projections indicates substantial agreement among participants regarding the measured rate of inflation that best satisfies the Federal Reserve's dual objectives of maximum employment and stable prices.

Figure 2.A. Distribution of participants' projections for the change in real GDP, 2009–12 and over the longer run



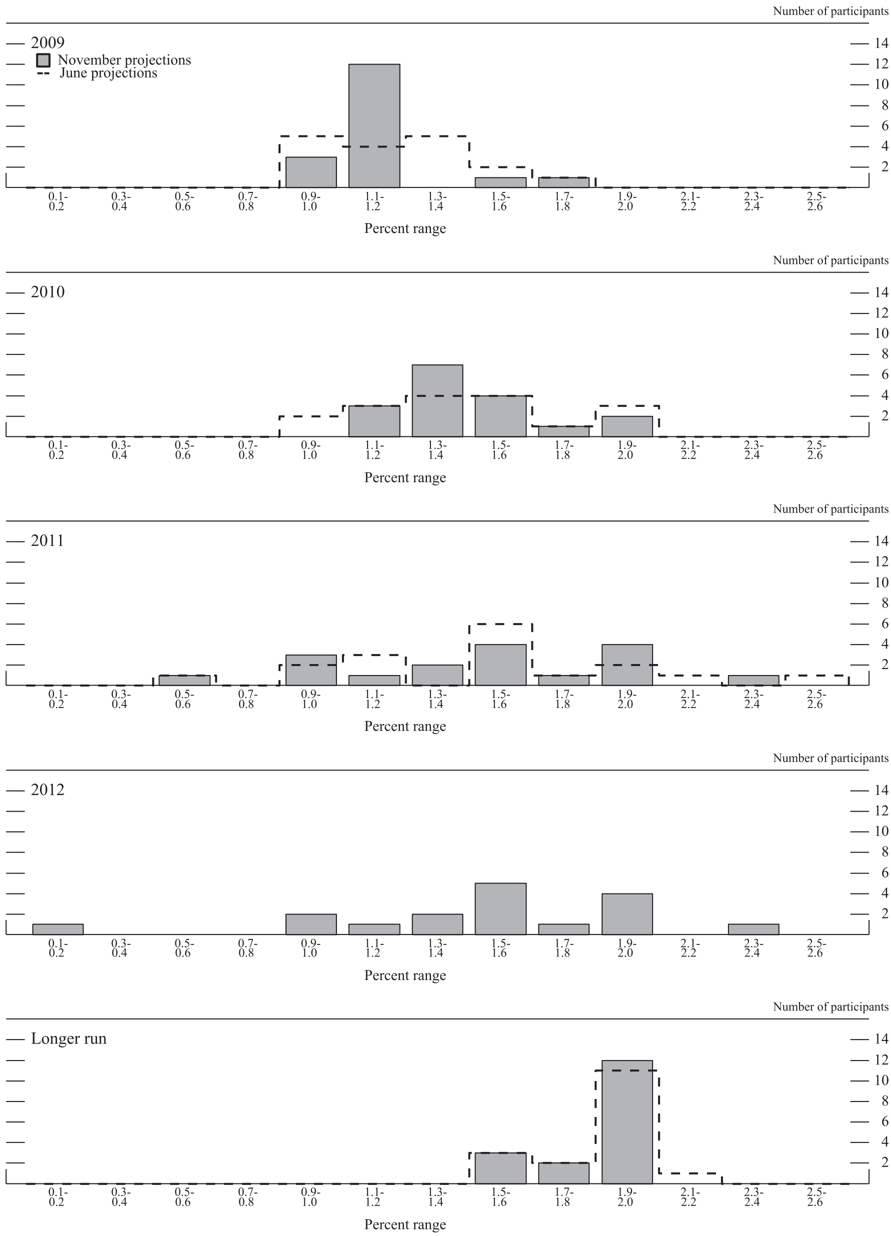
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.B. Distribution of participants' projections for the unemployment rate, 2009–12 and over the longer run



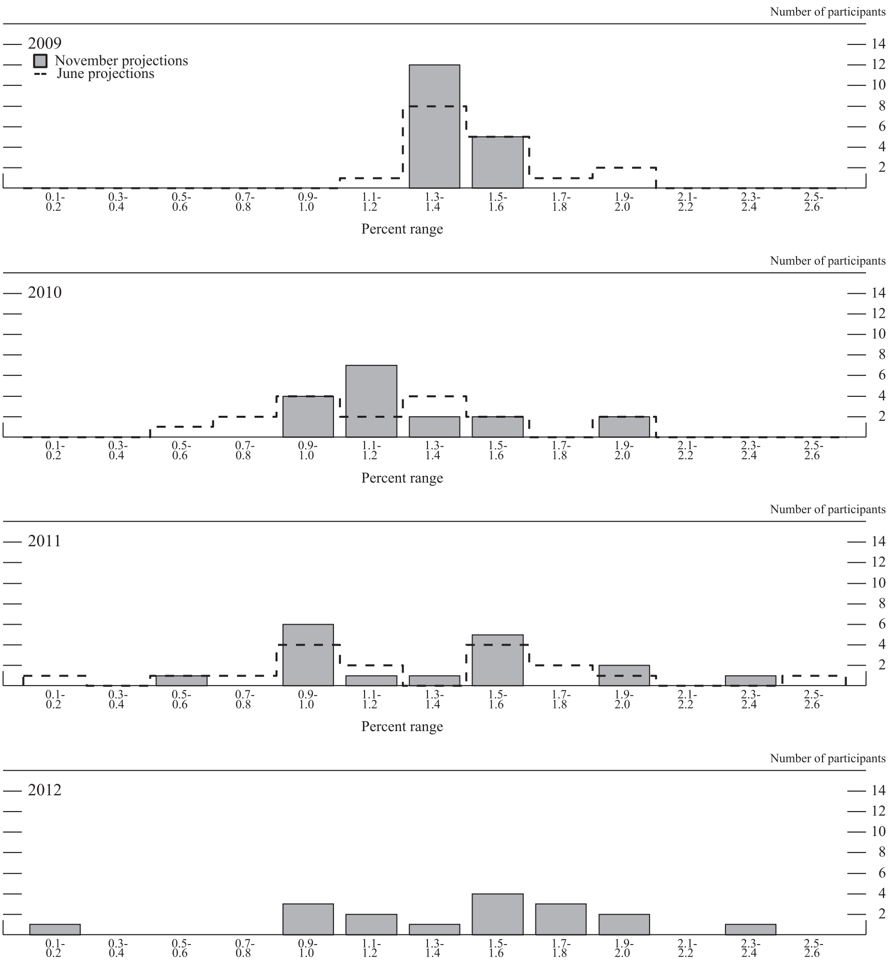
NOTE: Definitions of variables are in the general note to table 1.

Figure 2.C. Distribution of participants' projections for PCE inflation, 2009–12 and over the longer run



NOTE: Definitions of variables are in the general note to table 1.

Figure 2.D. Distribution of participants' projections for core PCE inflation, 2009–12



NOTE: Definitions of variables are in the general note to table 1.

Forecast Uncertainty

The economic projections provided by the members of the Board of Governors and the presidents of the Federal Reserve Banks inform discussions of monetary policy among policymakers and can aid public understanding of the basis for policy actions. Considerable uncertainty attends these projections, however. The economic and statistical models and relationships used to help produce economic forecasts are necessarily imperfect descriptions of the real world. And the future path of the economy can be affected by myriad unforeseen developments and events. Thus, in setting the stance of monetary policy, participants consider not only what appears to be the most likely economic outcome as embodied in their projections, but also the range of alternative possibilities, the likelihood of their occurring, and the potential costs to the economy should they occur.

Table 2 summarizes the average historical accuracy of a range of forecasts, including those reported in past *Monetary Policy Reports* and those prepared by Federal Reserve Board staff in advance of meetings of the Federal Open Market Committee. The projection error ranges shown in the table illustrate the considerable uncertainty associated with economic forecasts. For example, suppose a participant projects that real gross domestic product (GDP) and total consumer prices will rise steadily at annual rates of, respectively, 3 percent and 2 percent. If the uncertainty attending those projections is similar to that experienced in the past and the risks around the projections are broadly balanced, the numbers reported in table 2 would imply a probability of about 70 percent that actual GDP would expand within a range of 2.4 to 3.6 percent in the current year, 1.6 to 4.4 percent in the second year, 1.4 to 4.6 in the third year and 1.5 to 4.5 percent in the fourth year. The corresponding 70 percent confidence intervals for overall inflation would be 1.5 to 2.5 percent in the current year and 1.0 to 3.0 percent in the second, third and fourth years.

Because current conditions may differ from those that prevailed, on average, over history, participants provide judgments as to whether the uncertainty attached to their projections of each variable is greater than, smaller than, or broadly similar to typical levels of forecast uncertainty in the past as shown in table 2. Participants also provide judgments as to whether the risks to their projections are weighted to the upside, are weighted to the downside, or are broadly balanced. That is, participants judge whether each variable is more likely to be above or below their projections of the most likely outcome. These judgments about the uncertainty and the risks attending each participant's projections are distinct from the diversity of participants' views about the most likely outcomes. Forecast uncertainty is concerned with the risks associated with a particular projection rather than with divergences across a number of different projections.

Meeting Held on December 15–16, 2009

A joint meeting of the Federal Open Market Committee and the Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, December 15, 2009, at 2:00 p.m. and continued on Wednesday, December 16, 2009, at 9:00 a.m.

Present:

Mr. Bernanke, Chairman
Mr. Dudley, Vice Chairman
Ms. Duke
Mr. Evans
Mr. Kohn
Mr. Lacker
Mr. Lockhart
Mr. Tarullo
Mr. Warsh
Ms. Yellen

Mr. Bullard, Ms. Cumming, Mr. Hoenig, Ms. Pianalto, and Mr. Rosengren, Alternate Members of the Federal Open Market Committee

Messrs. Fisher, Kocherlakota, and Plosser, Presidents of the Federal Reserve Banks of Dallas, Minneapolis, and Philadelphia, respectively

Mr. Madigan, Secretary and Economist
Mr. Luecke, Assistant Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel
Mr. Sheets, Economist

Messrs. Altig, Clouse, Connors, Kamin, Slifman, Tracy, and Wilcox, Associate Economists

Mr. Sack, Manager, System Open Market Account

Ms. Johnson, Secretary of the Board, Office of the Secretary, Board of Governors

Mr. Parkinson, Director, Division of Bank Supervision and Regulation, Board of Governors

Mr. Frierson,[18] Deputy Secretary, Office of the Secretary, Board of Governors

Mr. Struckmeyer, Deputy Staff Director, Office of the Staff Director for Management, Board of Governors

Mr. English, Deputy Director, Division of Monetary Affairs, Board of Governors

Ms. Robertson, Assistant to the Board, Office of Board Members, Board of Governors

Ms. Edwards, Messrs. Levin[19] and Nelson,[18] Senior Associate Directors, Division of Monetary Affairs, Board of Governors; Messrs. Reifschneider and Wascher, Senior Associate Directors, Division of Research and Statistics, Board of Governors

Mr. Meyer, Senior Adviser, Division of Monetary Affairs, Board of Governors; Mr. Oliner, Senior Adviser, Division of Research and Statistics, Board of Governors

Ms. Zickler, Deputy Associate Director, Division of Research and Statistics, Board of Governors

Mr. Small, Project Manager, Division of Monetary Affairs, Board of Governors

Mr. Bassett, Section Chief, Division of Monetary Affairs, Board of Governors; Mr. Roberts,[19] Section Chief, Division of Research and Statistics, Board of Governors

Ms. Beattie,[20] Assistant to the Secretary, Office of the Secretary, Board of Governors

Ms. Low, Open Market Secretariat Specialist, Division of Monetary Affairs, Board of Governors

---

18. Attended Tuesday's session only.
19. Attended the portion of the meeting related to inflation dynamics.
20. Attended Wednesday's session only.

Mr. Williams, Records Management Analyst, Division of Monetary Affairs, Board of Governors

Messrs. Fuhrer and Rosenblum, Executive Vice Presidents, Federal Reserve Banks of Boston and Dallas, respectively

Mr. Krane, Ms. Mester, Messrs. Schweitzer and Waller, Senior Vice Presidents, Federal Reserve Banks of Chicago, Philadelphia, Cleveland, and St. Louis, respectively

Mr. Weber, Senior Research Officer, Federal Reserve Bank of Minneapolis

Messrs. Clark, Dotsey,[19] Fernald, Hornstein, Olivei,[19] and Wynne,[19] Vice Presidents, Federal Reserve Banks of Kansas City, Philadelphia, San Francisco, Richmond, Boston, Dallas, respectively

Messrs. Friedman and van der Klaauw,[19] Assistant Vice Presidents, Federal Reserve Bank of New York

Mr. Martinez-Garcia,[19] Research Economist, Federal Reserve Bank of Dallas

Developments in Financial Markets and the Federal Reserve's Balance Sheet

The Manager of the System Open Market Account reported on developments in domestic and foreign financial markets since the Committee's November 3–4 meeting. Financial conditions generally had become somewhat more supportive of economic growth. There was little evidence of year-end funding pressures, although demand for Treasury bills with maturities extending just beyond year-end remained elevated. The Manager also reported on System open market operations in agency debt and agency mortgage-backed securities (MBS) during the intermeeting period. The Desk continued to gradually slow the pace of purchases of these securities in accordance with the program for asset purchases that the Committee announced at the end of its November meeting. By unanimous vote, the Committee ratified those transactions. There were no open market operations in foreign currencies for the System's account during the intermeeting period. Since the Committee met in November, the Federal Reserve's total assets were about unchanged, at nearly $2.2 trillion, as the increase in the System's holdings of securities roughly matched a further decline in usage of the System's credit and liquidity facilities. The Manager noted that the System's holdings of securities will tend to decline gradually after the completion of the asset purchase programs, reflecting maturing issues and prepayments on holdings of MBS. The Manager noted that the Committee would likely wish to discuss in detail its policy for reinvesting the proceeds of maturing issues and prepayments; he proposed, as an interim approach, continuing the practice of not reinvesting the proceeds of maturing agency securities or MBS prepayments. Meeting participants supported that interim approach pending further discussion at future meetings.

The staff presented another update on the continuing development of several tools that could be used to support a smooth withdrawal of policy accommodation at the appropriate time; these tools include executing reverse repurchase agreements (RRPs) on a large scale and implementing a term deposit facility (TDF). To further test its RRP capabilities, in early December, the Desk executed a few small RRPs with primary dealers, using both Treasury and agency debt as collateral. These transactions confirmed the operational capability to execute triparty RRPs on a larger scale if so directed by the Committee. The Desk was continuing to develop the capacity to conduct RRPs using agency MBS collateral and anticipated that this work would be completed by the spring. In addition, the Desk reported that it was exploring the operational issues associated with expanding potential counterparties for RRPs beyond the primary dealers. Staff also reported significant progress in developing and implementing a TDF. The staff noted that it planned to ask the Board to approve a *Federal Register* notice requesting public comments on a TDF and summarized the contents of the draft notice.

The staff also briefed the Committee on recent developments regarding various Federal Reserve liquidity and credit facilities, including the Term Auction Facility (TAF), the primary credit program, and the Term Asset-Backed Securities Loan Facility (TALF). TAF auctions continued to be undersubscribed even as the Federal Reserve progressively reduced the total amount of funding available from the TAF. With the exception of the TALF, usage of the other facilities declined further as financial market conditions continued to improve. The TALF expanded modestly, supporting issuance of asset-backed securities collateralized by consumer, small business, and student loans as well as commercial mortgage-backed securities (CMBS). Indeed, over the intermeeting period, TALF lending supported the first new CMBS issue since June 2008. On November 17, the Board of Governors announced a reduction in the maximum maturity of loans available under the discount window's primary credit program from 90 days to 28 days, effective January 14, 2010. Participants agreed it would be useful to consider further steps the Federal Reserve might take to move toward normalization of its lending facilities at upcoming meetings, when the Committee plans to discuss alternative approaches to implementing monetary policy in the longer-run.

Staff Review of the Economic Situation

The information reviewed at the December 15–16 meeting suggested that the recovery in economic activity was gaining momentum. The pace of job losses slowed noticeably in recent months, and total hours worked increased in November; however, the unemployment rate remained quite elevated. Industrial production sustained the broad-based expansion that began in the third quarter, but capacity utilization remained very low. Consumer spending expanded solidly in October, reflecting in part a faster pace of motor vehicle sales. Both light vehicle sales and total retail sales rose again in November. Sales of new homes increased significantly in recent months, a development that, given the slow pace of construction, reduced the inventory of unsold new homes; sales of existing homes rose strongly. Spending on equipment and software continued to stabilize, but investment in nonresidential structures declined further as conditions in nonresidential real estate markets remained poor. Both imports and exports continued to recover from their depressed levels of earlier this year, and the U.S. trade deficit in September and October was wider than in earlier months. Although a jump in energy prices pushed up headline inflation somewhat, core consumer price inflation remained subdued.

Data received over the intermeeting period suggested that the pace of job loss slowed considerably in recent months relative to the steep declines that occurred in the first half of the year. The average decline in private payrolls in October and November was much smaller than in the third quarter; that recent improvement was widespread across industries. The length of the average workweek for production and nonsupervisory workers increased in November; moreover, aggregate hours worked registered the first substantial increase since the recession began. The unemployment rate dropped in November but remained quite high, while the labor force participation rate continued to decrease. The four-week moving average of initial claims for unemployment benefits declined somewhat through early December. Continuing claims for unemployment insurance through regular state programs also moved down, but the average length of spells of unemployment continued to increase.

After expanding briskly in the third quarter, industrial production increased further in October and November. The gains continued to be fairly broad based, and were particularly strong for consumer durables and materials. Business surveys suggested that factory output would advance further in the coming months. Capacity utilization rose again in November, but remained at a very low level by historical standards.

Real personal consumption expenditures increased at a solid pace in October, with broad-based advances in both goods and services. The data for nominal retail sales in November showed continued widespread improvement, particularly at general merchandise stores, electronics and appliance stores, and nonstore retailers. Outlays for motor vehicles bounced back in October after a slump in September that followed the end of the "cash-for-clunkers" program in August. Sales of new light vehicles increased again in November. Real disposable personal income rose in October, reflecting modest gains in nominal labor income; moreover, the increase in real after-tax income during the spring and summer was revised up. The latest readings from indexes of consumer sentiment remained within the relatively low range that prevailed over the previous six months, apparently still weighed down by weak labor market conditions and prior declines in household net worth.

Housing construction held fairly steady in recent months, while demand for housing continued to firm. Single-family housing starts remained roughly flat from June to November at levels only modestly above those reported earlier in the year. In the much smaller multifamily sector, where tight credit conditions persisted and vacancies stayed elevated, the average pace of starts in October and November decreased somewhat from the already very low rate in the third quarter. In contrast, sales of existing single-family homes increased significantly again in October. Sales of new homes also rose in October after two months of little change. With sales continuing to outpace construction, the inventory of unsold new homes declined to its lowest level in three years. The recent increases in sales likely reflected improved fundamentals: The average interest rate on 30-year conforming fixed-rate mortgages declined to less than 5 percent, and surveys suggested that households now expected home prices to be fairly stable over the next year. Although some house price indexes declined a little in September and October, they remained above the troughs reached last spring.

Real spending on equipment and software was estimated to have risen slightly in the third quarter after falling sharply for more than a year. Increased outlays for transportation equipment and high-tech goods accounted for the stabilization. Outside of those sectors, spending declined a bit further in the third quarter, although not as steeply as it had earlier in the year. Shipments of transportation and high-tech equipment remained strong in October, but shipments of nondefense capital goods excluding those categories declined, and new orders fell sharply across a range of products. Business purchases of motor vehicles rose significantly again in November. Moreover, monthly surveys of business conditions, sentiment, and capital spending plans pointed to a moderate rise in business spending going forward. In contrast, conditions in the nonresidential construction sector generally remained quite poor. For instance, real outlays on structures outside of the drilling and mining sector plunged in the third quarter. Also in the third quarter, vacancy rates on nonresidential properties rose further, and property prices continued to fall amid difficult financing conditions. The book value of manufacturing and trade inventories excluding motor vehicles and parts increased in October for the first time in more than a year, even as the ratio of such inventories to sales declined further. Capital markets continued to become somewhat more supportive of business investment over the intermeeting period. In contrast, available data indicated that banks continued to raise spreads on business loans.

The U.S. international trade deficit was somewhat wider in September and October than in previous months. Exports of goods and services increased sharply, and the gains were broadly distributed across most major categories of exports. After surging in September, imports flattened out in October, although the slowing almost entirely reflected reduced oil purchases. Most other categories of imports, including automotive goods, industrial supplies other than oil and gold, consumer goods, and capital goods, posted solid increases in the past two months.

The most recent data from the advanced foreign economies suggested that they continue to emerge from their deep recessions. Real gross domestic product (GDP) rose in the third quarter in Japan, the euro area, and Canada, and the pace of contraction in the United Kingdom moderated substantially. The limited data relating to the fourth quarter suggested that economic activity advanced in all of those economies. Surveys of purchasing managers and indicators of business and consumer confidence generally improved further. Data for October indicated that trade volumes continued to rise in each of these economies, retail sales increased in the United Kingdom and stopped declining in the euro area, housing starts climbed in Canada, and industrial production increased in Japan for the eighth consecutive month. Third-quarter real GDP growth was surprisingly strong in several emerging market economies, most notably Mexico and India. In emerging Asia and in Latin America, indicators suggested that economic activity was expanding somewhat less rapidly, but still briskly, in the fourth quarter. Price pressures remained subdued in most of the advanced foreign economies, although headline inflation generally moved up. Headline inflation also increased in emerging Asia, generally from low levels, but declined further in Latin America, likely in part because of the recent appreciation of several Latin American currencies.

In the United States, the latest data indicated that total consumer price inflation turned up in recent months, while core consumer price inflation remained subdued. The higher readings on headline consumer price inflation were the result of a rebound in energy prices. Core consumer prices increased modestly in October and were unchanged in November. Median year-ahead inflation expectations in the Reuters/University of Michigan Survey of Consumers declined in early December, and the same survey's measure of longer-term inflation expectations moved down to the lower end of the narrow range that prevailed over the previous few years. Revised data showed solid increases in hourly compensation in the second and third quarters, along with quite rapid productivity growth and a further decline in unit labor costs. Average hourly earnings of production and nonsupervisory workers increased modestly, on average, in October and November.

Staff Review of the Financial Situation

Market participants largely anticipated the decisions by the Federal Open Market Committee (FOMC) at the November meeting to keep the target range for the federal funds rate unchanged and to retain the "extended period" language in the accompanying statement. However, market participants took note of the Committee's explicit enumeration of the factors that were expected to continue to warrant this policy stance, and Eurodollar futures rates fell a bit on the release. In contrast, the announcement that the Federal Reserve would purchase only about $175 billion of agency debt securities had not been generally anticipated. Spreads on those securities widened a few basis points following the release, but declined, on net, over the intermeeting period. Incoming economic data, while somewhat better than expected, seemed to have little net effect on interest rate expectations. Indeed, the expected path of the federal funds rate shifted down somewhat over the intermeeting period. Consistent with the decrease in short-term interest rates, yields on 2-year nominal off-the-run Treasury securities declined slightly, on net, over the intermeeting period. In contrast, yields on nominal 10-year Treasury securities edged higher on balance. Inflation compensation based on 5-year Treasury inflation-protected securities (TIPS) increased, apparently owing in part to an announcement by the Treasury of a smaller-than-expected amount of issuance of TIPS next year. Five-year inflation compensation five years ahead also rose, and was near the upper end of its range in recent years.

Conditions in short-term funding markets were little changed over the intermeeting period. Spreads between London interbank offered rates (Libor) and overnight index swap (OIS) rates at one- and three-month maturities were about flat; spreads at the six-month maturity narrowed somewhat further but remained above pre-crisis levels. Spreads on A2/P2-rated commercial paper (CP) and AA-rated asset-backed CP remained near their lows of the past two years. Indicators of functioning in the market for nominal Treasury securities—including trading volumes and liquidity premiums for the on-the-run 10-year note—were roughly stable. Liquidity conditions in the TIPS market showed further improvement. Year-end pressures in short-term funding markets, including the CP and bank funding markets, remained modest. However, high demand for Treasury bills maturing just past December 31 drove yields on such issues to zero in some recent auctions.

Over the intermeeting period, broad stock price indexes increased further. The rise in share prices likely reflected the improvement in the economic outlook and strong third-quarter earnings, which led analysts to mark up their estimates of future earnings. The gains were widespread across industry sectors. However, financial stocks significantly underperformed the market, as investors continued to express concerns about the future profitability of the banking industry. Option-implied volatility on the S&P 500 index declined. The spread between an estimate of the expected real return on equity over the next 10 years and an estimate of the real 10-year Treasury yield—a rough gauge of the equity risk premium—remained about unchanged at a relatively high level. Yields on investment- and speculative-grade corporate bonds fell a little more than those on comparable-maturity nominal Treasury securities, leaving their spreads somewhat narrower. Bid-asked spreads for corporate bonds—a measure of the liquidity of such instruments—were about unchanged. Prices and bid-asked spreads in the secondary market for leveraged loans also were stable over the intermeeting period. Spreads on credit default swaps (CDS) for large bank holding companies narrowed a bit.

Debt of the private domestic nonfinancial sector appeared to be declining again in the fourth quarter, as estimates suggested a further drop in household debt and a tick down in nonfinancial business debt. Consumer credit contracted for the ninth consecutive month in October, reflecting a steep decline in revolving credit that offset a small increase in nonrevolving credit. Issuance of consumer credit asset-backed securities rebounded in November from its subdued pace in October. Moreover, with support from the TALF, the first CMBS issue in nearly 18 months came to market. A few other CMBS deals were subsequently completed without support from the TALF. Business debt was held down in November by another drop in bank loans, as well as a decrease in CP outstanding, though the latter was concentrated among a few large firms. In contrast, gross issuance of investment- and speculative-grade bonds was robust in November. The federal government continued to issue debt at a brisk pace, and gross issuance of state and local government debt remained strong in November.

Commercial bank credit decreased further in November, although the pace of decline slowed relative to recent months. Commercial and industrial (C&I) loans continued to drop, likely reflecting weak demand and a continued tightening of credit terms by banks. The Survey of Terms of Business Lending conducted in November indicated that the average C&I loan rate spread over comparable-maturity market instruments rose for the fifth consecutive survey. The runoff in commercial real estate loans continued, consistent with the further weakening of fundamentals in that sector. Bank loans to households rose, reflecting a slowdown in loan sales to the housing-related government-sponsored enterprises that resulted in a modest increase in banks' on-balance-sheet holdings of closed-end residential mortgages in November. However, home equity loans and consumer loans fell again. According to third-quarter Call Report data, unused loan commitments shrank for the seventh consecutive quarter, though the rate of decline slowed, especially for commitments to lend to businesses. The aggregate profitability of the banking sector turned positive in the third quarter, but most of the increase was due to strong earnings at a few large institutions. Credit quality appeared to worsen as delinquency and charge-off rates increased further for most major loan categories. Banks' regulatory capital ratios increased again as banks continued to raise equity and shrink their balance sheets.

M2 expanded at a moderate rate in November. As was the case in recent months, liquid deposits grew rapidly, while small time deposits and retail money market mutual funds contracted, albeit at slightly slower paces. Currency declined somewhat in November as foreign demand for U.S. banknotes appeared to ebb, consistent with the continued stabilization in most global financial markets.

Broad stock price indexes in major advanced foreign economies rose, although generally somewhat less than those in the United States. Stock price indexes in major emerging markets increased as well, particularly in Brazil and Mexico, amid generally rising commodity prices and a better-than-expected Mexican GDP report; Chinese stock prices also increased strongly. Long-term government bond yields declined in most advanced foreign economies, but increased in the United Kingdom. The dollar depreciated over much of the intermeeting period, but then reversed course following the release of better-than-expected U.S. data on employment and retail sales for November. On balance, the dollar ended the period up slightly against the major foreign currencies and down a little relative to the currencies of other important trading partners.

Concerns about the potential for default by some sovereign borrowers rose over the intermeeting period. News that the Dubai government had requested a standstill on debts owed by Dubai World, a government-owned corporation, temporarily roiled some financial markets. However, those pressures eased as investors concluded that Dubai World's difficulties were likely to be isolated. Subsequently, the sovereign debt rating for Greece was lowered amid long-standing concerns over its public finances and a widening of its sovereign CDS spreads.

Although the central banks of the major foreign industrial economies kept policy rates on hold, the Bank of England expanded its asset purchase program and the Bank of Japan announced a new secured lending facility. In contrast, the European Central Bank took some initial steps toward scaling back emergency lending. It announced that the one-year refinancing operation in December would be its last and that the cost of the funds provided would float with interest rates set in future refinancing operations rather than being fixed as in previous such operations.

Staff Economic Outlook

In the forecast prepared for the December FOMC meeting, the staff raised its projection for average real GDP growth in the second half of 2009 somewhat, and it also modestly increased its forecast for economic growth in 2010 and 2011. Better-than-expected data on employment, consumer spending, home sales, and industrial production received during the intermeeting period pointed to a somewhat stronger increase in real GDP in the current quarter than had previously been projected. In addition, the positive signal from the incoming data, along with the sizable upward revisions to household income in earlier quarters and more supportive financial market conditions, led to small upward adjustments to projected growth in real GDP over the rest of the forecast period. The staff again anticipated that the recovery would strengthen in 2010 and 2011, supported by further improvement in financial conditions and household balance sheets, continued recovery in the housing sector, growing household and business confidence, and accommodative monetary policy, even as the impetus to real activity from fiscal policy diminished. However, the projected pace of real output growth in 2010 and 2011 was expected to exceed that of potential output by only enough to produce a very gradual reduction in economic slack.

The staff forecast for inflation was nearly unchanged. The staff interpreted the increases in prices of energy and nonmarket services that recently boosted consumer price inflation as largely transitory. Although the projected degree of slack in resource utilization over the next two years was a little lower than shown in the previous staff forecast, it was still quite substantial. Thus, the staff continued to project that core inflation would slow somewhat from its current pace over the next two years. Moreover, the staff expected that headline consumer price inflation would decline to about the same rate as core inflation in 2010 and 2011.

Participants' Views on Current Conditions and the Economic Outlook

In their discussion of the economic situation and outlook, meeting participants agreed that the incoming data and information received from business contacts suggested that economic growth was strengthening in the fourth quarter, that firms were reducing payrolls at a less rapid pace, and that downside risks to the outlook for economic growth had diminished a bit further. Although some of the recent data had been better than anticipated, most participants saw the incoming information as broadly in line with the projections for moderate growth and subdued inflation in 2010 that they had submitted just before the Committee's November 3–4 meeting; accordingly, their views on the economic outlook had not changed appreciably. Participants expected the economic recovery to continue, but, consistent with experience following previous financial crises, most anticipated that the pickup in output and employment growth would be rather slow relative to past recoveries from deep recessions. A moderate pace of expansion would imply slow improvement in the labor market next year, with unemployment declining only gradually. Participants agreed that underlying inflation currently was subdued and was likely to remain so for some time. Some noted the risk that, over the next couple of years, inflation could edge further below the rates they judged most consistent with the Federal Reserve's dual mandate for maximum employment and price stability; others saw inflation risks as tilted toward the upside in the medium term.

A number of factors were expected to support near-term expansion in economic activity. Consumer spending appeared to be on a moderately rising trend, reflecting gains in after-tax income and wealth this year. Recent upward revisions to official estimates of the level of household income in recent quarters gave participants somewhat greater confidence that consumer spending would continue to expand. The housing sector showed continuing signs of improvement, though housing starts had leveled out after increasing earlier in the year and activity remained quite low. Businesses seemed to be reducing the pace of inventory reductions. The outlook for growth abroad had improved since earlier in the year, auguring well for U.S. exports. In addition, financial market conditions generally had become more supportive of economic growth. While these developments were positive, participants noted several factors that likely would continue to restrain the expansion in economic activity. Business contacts again emphasized they would be cautious in adding to payrolls and capital spending, even as demand for their products increases. Conditions in the commercial real estate (CRE) sector were still deteriorating. Bank credit had contracted further, and with many banks facing continuing loan losses, tight bank credit could continue to weigh on the spending of some households and businesses. Some participants remained concerned about the economy's ability to generate a self-sustaining recovery without government support. In particular, they noted the risk that improvements in the housing sector might be undercut next year as the Federal Reserve's purchases of MBS wind down, the homebuyer tax credits expire, and foreclosures and distress sales continue. Though the near-term outlook remains uncertain, participants generally thought the most likely outcome was that economic growth would gradually strengthen over the next two years as financial conditions improved further, leading to more-substantial increases in resource utilization.

Financial market conditions were generally regarded as having become more supportive of continued economic recovery during the intermeeting period: Equity prices rose further, private credit spreads narrowed somewhat, and financial markets generally continued to function significantly better than early in the year. Participants noted, however, that securitization markets were still substantially impaired. In general, U.S. asset values did not seem out of line with improving fundamentals. While investors evidently had become less cautious and more willing to bear risk, they appeared to be discriminating among risky assets. Banks were raising new capital and in some cases paying back funds received from the Troubled Asset Relief Program. Bank loans, however, continued to contract sharply in all categories, reflecting lack of demand, deterioration in potential borrowers' credit quality, uncertainty about the economic outlook, and banks' concerns about their own capital positions. With rising levels of nonperforming loans expected to be a continuing source of stress, and with many regional and small banks vulnerable to the deteriorating performance of CRE loans, bank lending terms and standards were seen as likely to remain tight. Participants again noted the contrast between large and small firms' access to financing. Large firms that can issue debt in the markets appeared to have relatively little difficulty obtaining credit. In contrast, smaller firms, which tend to be more dependent on commercial banks for financing, reportedly faced substantial constraints in gaining access to credit. While survey evidence suggested that small businesses considered weak demand to be a larger problem than access to credit, participants saw limited credit availability as a potential constraint on future investment and hiring by small businesses, which normally are a significant source of employment growth in recoveries.

The weakness in labor markets continued to be an important concern to meeting participants, who generally expected unemployment to remain elevated for quite some time. The unemployment rate was not the only indicator pointing to substantial slack in labor markets: The employment-to-population ratio had fallen to a 25-year low, and aggregate hours of production workers had dropped more than during the 1981–82 recession. Although the November employment report was considerably better than anticipated, several participants observed that more than one good report would be needed to provide convincing evidence of recovery in the labor market. Participants also noted that the slowing pace of employment declines mainly reflected a diminished pace of layoffs; few firms were hiring. Moreover, the unusually large fraction of those individuals with jobs who were working part time for economic reasons, as well as the uncommonly low level of the average workweek, pointed to only a gradual decline in unemployment as the economic recovery proceeded. Indeed, many business contacts again reported that they would be cautious in their hiring, saying they expected to meet any near-term increase in demand by raising their existing employees' hours and boosting productivity, thus delaying the need to add employees. The necessity of reallocating labor across sectors as the recovery proceeds, as well as the loss of skills caused by high levels of long-term unemployment and permanent separations, also could limit the pace of employment gains. Nonetheless, the reported rise in employment of temporary workers in recent months could presage a broader increase in job growth and thus was a welcome development.

The prognosis for labor markets remained an important factor in the outlook for consumer spending. Recent data on household expenditures were encouraging. Retail sales increased, spurred by price discounting. The Bureau of Economic Analysis revised up its estimates of the level of real disposable income—and thus of the personal saving rate—in the second and third quarters of this year. Those revisions, along with recent gains in equity prices, suggested a smaller probability that households would reduce spending to rebuild their savings more rapidly. However, uncertain job prospects, modest growth in real incomes, tight credit, and wealth levels that remained relatively low despite this year's rise in equity prices and stabilization in house prices were seen as likely to weigh on consumer confidence and the growth of consumer spending for some time to come. Anecdotal evidence on consumer spending in this year's holiday season was mixed.

Participants noted that firms had made substantial progress in reducing inventories toward desired levels and were cutting stocks at a slower pace than earlier in the year. This adjustment likely was making an important contribution to economic growth in the fourth quarter, and participants expected that it would do so into 2010 as well. The combination of rising consumer spending, slower destocking, and rising goods production was reflected in reports from major transportation companies that shipping volumes were up.

Investment in equipment and software appeared to have stabilized, and recent data on new orders continued to point to some pickup next year. Even so, many participants expressed the view that cautious business sentiment, together with low industrial utilization rates, was likely to keep new capital spending subdued until firms became more confident about the durability of increases in demand. Many also noted widespread reports from business contacts that uncertainties about health-care, tax, and environmental policies were adding to businesses' reluctance to commit to higher capital spending. CRE activity continued to fall markedly in most parts of the country as a result of deteriorating fundamentals, including declining occupancy and rental rates, and very tight credit conditions. Prospects for nonresidential construction remained weak.

In the residential real estate sector, home sales and construction had risen relative to the very low levels reported in the spring; moreover, house prices appeared to be stabilizing and in some areas had reportedly moved higher. Generally, the outlook was for gains in housing activity to continue. However, some participants still viewed the improved outlook as quite tentative and again pointed to potential sources of softness, including the termination next year of the temporary tax credits for homebuyers and the downward pressure that further increases in foreclosures could put on house prices. Moreover, mortgage markets could come under pressure as the Federal Reserve's agency MBS purchases wind down.

Stronger foreign economic activity, especially in the emerging market economies in Asia, as well as the partial reversal this year of the dollar's appreciation during the latter part of 2008, was providing further support to U.S. exports, including agricultural exports. Further improvements in foreign economies would likely buoy U.S. exports going forward, but import growth would also strengthen as the recovery took hold in the United States. Participants noted that any tendency for dollar depreciation to put significant upward pressure on inflation would bear close watching.

Most participants anticipated that substantial slack in labor and product markets, along with well-anchored inflation expectations, would keep inflation subdued in the near term, although they had differing views as to the relative importance of those two factors. The decelerations in wages and unit labor costs this year, and the accompanying deceleration in marginal costs, were cited as factors putting downward pressure on inflation. Moreover, anecdotal evidence suggested that most firms had little ability to raise their prices in the current economic environment. Some participants noted, however, that rising prices of oil and other commodities, along with increases in import prices, could boost inflation pressures going forward. Overall, many participants viewed the risks to their inflation outlooks as being roughly balanced. Some saw inflation risks as tilted to the downside, reflecting the quite elevated level of economic slack and the possibility that inflation expectations could begin to decline in response to the low level of actual inflation. But others felt that inflation risks were tilted to the upside, particularly in the medium term, because of the possibility that inflation expectations could rise as a result of the public's concerns about extraordinary monetary policy stimulus and large federal budget deficits. Moreover, a few participants noted that banks might seek, as the economy improves, to reduce their excess reserves quickly and substantially by purchasing securities or by easing credit standards and expanding their lending. A rapid shift, if not offset by Federal Reserve actions, could give excessive impetus to spending and potentially result in expected and actual inflation higher than would be consistent with price stability. To keep inflation expectations anchored, all participants agreed that monetary policy would need to be responsive to any significant improvement or worsening in the economic outlook and that the Federal Reserve would need to continue to clearly communicate its ability and intent to begin withdrawing monetary policy accommodation at the appropriate time and pace.

In the Committee's discussion of monetary policy for the period ahead, all members agreed that no changes to the Committee's large-scale asset purchase programs, or to its target range for the federal funds rate, were warranted at this meeting, inasmuch as the economic outlook had changed little since the November meeting. Accordingly, the Committee affirmed its intention to purchase \$1.25 trillion of agency MBS and about \$175 billion of agency debt by the end of the first quarter of 2010 and to gradually slow the pace of these purchases to promote a smooth transition in markets. The Committee emphasized that it would continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets. A few members noted that resource slack was expected to diminish only slowly and observed that it might become desirable at some point in the future to provide more policy stimulus by expanding the planned scale of the Committee's large-scale asset purchases and continuing them beyond the first quarter, especially if the outlook for economic growth were to weaken or if mortgage market functioning were to deteriorate. One member thought that the improvement in financial market conditions and the economic outlook suggested that the quantity of planned asset purchases could be scaled back, and that it might become appropriate to begin reducing the Federal Reserve's holdings of longer-term assets if the recovery gains strength over time. The Committee maintained the federal funds target range at 0 to ¼ percent and, based on the outlook for a slow economic recovery, decided to reiterate its anticipation that economic conditions, including low levels of resource utilization, subdued inflation trends, and stable inflation expectations, were likely to warrant exceptionally low rates for an extended period. Although members generally saw little risk that maintaining very low short-term interest rates could raise inflation expectations or create instability in asset markets, they noted that it was important to remain alert to these risks. All agreed that the path of short-term rates going forward would depend on the evolution of the economic outlook.

Committee members and Board members agreed that there had been substantial improvements in the functioning of financial markets; accordingly they agreed that the statement to be released following the meeting should indicate an anticipation that most of the Federal Reserve's special liquidity facilities will expire on February 1, 2010; these facilities include the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, the Primary Dealer Credit Facility, and the Term Securities Lending Facility. Committee members also agreed to announce that the Federal Reserve will be working with its central bank counterparties to close its temporary liquidity swap arrangements by February 1. In addition, the statement would announce an expectation that amounts provided under the Term Auction Facility will continue to be scaled back in early 2010, and that the anticipated expiration dates for the Term Asset-Backed Securities Loan Facility remained June 30, 2010, for loans backed by new-issue CMBS, and March 31, 2010, for loans backed by all other types of collateral. Members emphasized that they were prepared to modify these plans if necessary to support financial stability and economic growth. In that context, several members noted that the TALF was still providing important support for securitization markets, particularly the CMBS market, and that improvements in the functioning of securitization markets were lagging behind those in other financial markets.

At the conclusion of the discussion, the Committee voted to authorize and direct the Federal Reserve Bank of New York, until it was instructed otherwise, to execute transactions in the System Account in accordance with the following domestic policy directive:

"The Federal Open Market Committee seeks monetary and financial conditions that will foster price stability and promote sustainable growth in output. To further its long-run objectives, the Committee seeks conditions in reserve markets consistent with federal funds trading in a range from 0 to ¼ percent. The Committee directs the Desk to purchase agency debt and agency MBS during the intermeeting period with the aim of providing support to private credit markets and economic activity. The timing and pace of these purchases should depend on conditions in the markets for such securities and on a broader assessment of private credit market conditions. The Desk is expected to execute purchases of about $175 billion in housing-related agency debt and about $1.25 trillion of agency MBS by the end of the first quarter of 2010. The Desk is expected to gradually slow the pace of these purchases as they near completion. The Committee anticipates that outright purchases of securities will cause the size of the Federal Reserve's balance sheet to expand significantly in coming months. The System Open Market Account Manager and the Secretary will keep the Committee informed of ongoing developments regarding the System's balance sheet that could affect the attainment over time of the Committee's objectives of maximum employment and price stability."

The vote encompassed approval of the statement below to be released at 2:15 p.m.:

"Information received since the Federal Open Market Committee met in November suggests that economic activity has continued to pick up and that the deterioration in the labor market is abating. The housing sector has shown some signs of improvement over recent months. Household spending appears to be expanding at a moderate rate, though it remains constrained by a weak labor market, modest income growth, lower housing wealth, and tight credit. Businesses are still cutting back on fixed investment, though at a slower pace, and remain reluctant to add to payrolls; they continue to make progress in bringing inventory stocks into better alignment with sales. Financial market conditions have become more supportive of economic growth. Although economic activity is likely to remain weak for a time, the Committee anticipates that policy actions to stabilize financial markets and institutions, fiscal and monetary stimulus, and market forces will contribute to a strengthening of economic growth and a gradual return to higher levels of resource utilization in a context of price stability.

With substantial resource slack likely to continue to dampen cost pressures and with longer-term inflation expectations stable, the Committee expects that inflation will remain subdued for some time.

The Committee will maintain the target range for the federal funds rate at 0 to ¼ percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the federal funds rate for an extended period. To provide support to mortgage lending and housing markets and to improve overall conditions in private credit markets, the Federal Reserve is in the process of purchasing $1.25 trillion of agency mortgage-backed securities and about $175 billion of agency debt. In order to promote a smooth transition in markets, the Committee is gradually slowing the pace of these purchases, and it anticipates that these transactions will be executed by the end of the first quarter of 2010. The Committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets.

In light of ongoing improvements in the functioning of financial markets, the Committee and the Board of Governors anticipate that most of the Federal Reserve's special liquidity facilities will expire on February 1, 2010, consistent with the Federal Reserve's announcement of June 25, 2009. These facilities include the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, the Commercial Paper Funding Facility, the Primary Dealer Credit Facility, and the Term Securities Lending Facility. The Federal Reserve will also be working with its central bank counterparties to close its temporary liquidity swap arrangements by February 1. The Federal Reserve expects that amounts provided under the Term Auction Facility will continue to be scaled back in early 2010. The anticipated expiration dates for the Term Asset-Backed Securities Loan Facility remain set at June 30, 2010, for loans backed by new-issue commercial mortgage-backed securities and March 31, 2010, for loans backed by all other types of collateral. The Federal Reserve is prepared to modify these plans if necessary to support financial stability and economic growth."

> Voting for this action: Messrs. Bernanke and Dudley, Ms. Duke, Messrs. Evans, Kohn, Lacker, Lockhart, Tarullo, and Warsh, and Ms. Yellen.
>
> Voting against this action: None.

Following the Committee's policy decision, staff gave several presentations on the key determinants of inflation dynamics. Theoretical and empirical research indicates that inflation can respond to deviations of economic activity from its longer-run sustainable path. However, in some theoretical frameworks, the connection between resource slack and inflation depends on the nature of the shock and its impact on marginal costs and markups. Moreover, estimates of the magnitude of slack and its effect on inflation are sensitive to the details of the analytical framework and the statistical methodology used in each study. While theory suggests that the degree of slack prevailing in foreign economies could affect domestic inflation, empirical evidence on the importance of such an effect was mixed. Evidence suggested that sizable shifts in the longer-run inflation expectations of households and firms had influenced the evolution of inflation over previous decades; in contrast, the anchoring of inflation expectations in recent years likely had damped somewhat the response of actual inflation to the recent economic downturn and to fluctuations in the prices of energy and other commodities. In discussing these issues, participants noted that they bear in mind the shocks hitting the economy and regularly monitor more than one measure of resource slack as they assess the outlook for economic activity and inflation. They also noted the importance of formulating monetary policy in ways that would work well across a range of possible economic structures rather than relying on any one analytical framework. Finally, they underscored the importance of keeping longer-run inflation expectations firmly anchored to help achieve the Federal Reserve's dual mandate for maximum employment and price stability.

It was agreed that the next meeting of the Committee would be held on Tuesday–Wednesday, January 26–27, 2010. The meeting adjourned at 1:00 p.m. on December 16, 2009.

Notation Votes

By notation vote completed on November 23, 2009, the Committee unanimously approved the minutes of the

FOMC meeting held on November 3–4, 2009.

By notation vote completed on November 24, 2009, the Committee unanimously approved the following resolution:

"The Federal Open Market Committee authorizes the Federal Reserve Bank of New York to conduct reverse repo transactions involving U.S. Government securities, and securities that are direct obligations of, or fully guaranteed as to principal and interest by, any agency of the United States, for the purpose of helping to ensure the readiness of the Federal Reserve's tools for absorbing bank reserves. The reverse repo transactions authorized in this resolution shall have terms to maturity of 20 business days or less and the total amount of all transactions outstanding at a given time shall be $5 billion or less."

Brian F. Madigan
Secretary

Litigation

During 2009, the Board of Governors was a party in ten lawsuits or appeals filed that year and in seven other cases pending from previous years, for a total of seventeen cases. In 2008, the Board had been a party in a total of eleven cases. As of December 31, 2009, ten cases were pending.

Gold Anti-Trust Action Committee, Inc., v. Board of Governors, No. 09-2436 (D. District of Columbia, filed December 30, 2009), is a Freedom of Information Act case.

Judicial Watch, Inc. v. Board of Governors, No. 09-2138 (D. District of Columbia, filed November 13, 2009), is a Freedom of Information Act case.

Citizens for Responsibility and Ethics in Washington v. Board of Governors, No. 09-2113 (D. District of Columbia, filed November 10, 2009), is a Freedom of Information Act case.

McKinley v. Board of Governors, No. 09-1263 (D. District of Columbia, filed July 8, 2009), is a Freedom of Information Act case.

Odoski v. Bernanke, No. 09-cv-718 (W.D. Pennsylvania, filed June 5, 2009), was an employment discrimination case. On December 29, 2009, the district court dismissed the action.

Citizens for Responsibility and Ethics in Washington v. Board of Governors, No. 09-663 (D. District of Columbia, filed April 16, 2009), was a Freedom of Information Act case. On November 19, 2009, the district court granted the Board's motion for summary judgment.

The New York Times Company v. Board of Governors, No. 09-2645 (S.D. New York, filed March 23, 2009), was a Freedom of Information Act case. The court dismissed the case on the parties' motion on November 30, 2009.

Freedom Watch, Inc., v. Board of Governors, No. 09-331 (D. District of Columbia, filed February 19, 2009), was a Freedom of Information Act case. The district court granted the Board's motion to dismiss the action on August 12, 2009.

Barlow v. Federal Reserve System, No. 09-177 (D. District of Columbia, filed February 25, 2009), was an action for writ of mandamus regarding a student loan. On September 1, 2009, the district court dismissed the case.

Fox News Network v. Board of Governors, No. 09-272 (S.D. New York, filed January 13, 2009), is a Freedom of Information Act case. On July 30, 2009, the district court granted the Board's motion for summary judgment (639 F. Supp. 2d 84). The plaintiff's appeal to the Second Circuit (09-3795, filed September 11, 2009) is pending.

Murray v. Board of Governors, No. 08-cv-15147 (E.D. Michigan, filed December 15, 2008), is a challenge to the constitutionality of federal expenditures relating to American International Group (AIG).

Bumgarner v. Paulson, Bernanke, et al., No. 08-cv-5245 (D. New Jersey, amended complaint filed November 21, 2008), was a challenge to the implementation of the Economic Emergency Stabilization Act of 2008. On August 10, 2009, the district court dismissed the action.

Bloomberg, L.P. v. Board of Governors, No. 08-cv-9595 (S.D. New York, filed November 7, 2008), is a Freedom of Information Act case. On August 4, 2009, the district court granted the plaintiff's motion for summary judgment (649 F. Supp. 2d 262). The Board's appeal to the Second Circuit (09-4083, filed October 1, 2009) is pending.

Schulz v. United States Federal Reserve System, No. 1:08-cv-991 (N.D. New York, filed September 18, 2008), is an action relating to the Federal Reserve's loan to American International Group. On September 25, 2008, the district court denied plaintiff's request for a temporary restraining order and preliminary injunction. On September 30, 2008, the plaintiff appealed the district court's order to the United States Court of Appeals for the Second Circuit (No. 08-4810).

Jones v. Greenspan, No. 04-1696 (D. District of Columbia, filed October 4, 2004), is an employment discrimination case. On March 10, 2008, the district court granted the Board's motion and dismissed the plaintiff's claims. On the plaintiff's appeal (No. 08-5092, filed April 21, 2008), the District of Columbia Circuit affirmed in part and reversed in part, and remanded the action to the district court. 557 F.3d 670.

Chandler v. Bernanke, No. 06-2082 (D. District of Columbia, filed December 6, 2006), was an employment discrimination action. On September 21, 2009, the case was dismissed on the parties' stipulation.

Artis v. Greenspan, No. 09-5121 (District of Columbia Circuit, filed April 9, 2009), is an appeal from the district court's dismissal of the plaintiffs' employment discrimination claim (474 F. Supp. 2d 16 (January 31, 2007)) and subsequent denial of the plaintiffs' motion to alter or amend judgment (256 F.R.D. 4 (March 2, 2009)). ■

Federal Reserve System Organization

Board of Governors

December 31, 2009

Members

	Term expires January 31,
Ben S. Bernanke, *Chairman*[1]	2020
Donald L. Kohn, *Vice Chairman*[1]	2016
Kevin M. Warsh	2018
Elizabeth A. Duke	2012
Daniel K. Tarullo	2022

Officers

Office of Board Members

Michelle A. Smith, *Director*

Linda L. Robertson, *Assistant to the Board*

Laricke D. Blanchard, *Assistant to the Board*

Rosanna Pianalto-Cameron, *Assistant to the Board*

David W. Skidmore, *Assistant to the Board*

Brian J. Gross, *Special Assistant to the Board for Congressional Liaison*

Robert M. Pribble, *Special Assistant to the Board for Congressional Liaison*

Lucretia M. Boyer, *Special Assistant to the Board for Public Information*

Winthrop P. Hambley, *Senior Adviser*

Legal Division

Scott G. Alvarez, *General Counsel*

Richard M. Ashton, *Deputy General Counsel*

Kathleen M. O'Day, *Deputy General Counsel*

Stephanie Martin, *Associate General Counsel*

Ann Misback, *Associate General Counsel*

Katherine H. Wheatley, *Associate General Counsel*

Kieran J. Fallon, *Associate General Counsel*

Stephen H. Meyer, *Assistant General Counsel*

Patricia A. Robinson, *Assistant General Counsel*

Mark E. Van Der Weide, *Assistant General Counsel*

Cary K. Williams, *Assistant General Counsel*

Office of the Secretary

Jennifer J. Johnson, *Secretary*

Robert deV. Frierson, *Deputy Secretary*

Margaret M. Shanks, *Associate Secretary*

Division of International Finance

D. Nathan Sheets, *Director*

Thomas A. Connors, *Deputy Director*

Steven B. Kamin, *Deputy Director*

Joseph E. Gagnon, *Associate Director*

Michael P. Leahy, *Associate Director*

Ralph W. Tryon, *Associate Director*

Trevor A. Reeve, *Deputy Associate Director*

John H. Rogers, *Deputy Associate Director*

Christopher J. Erceg, *Assistant Director*

Linda S. Kole, *Assistant Director*

Mark S. Carey, *Adviser*

Jane Haltmaier, *Adviser*

Division of Monetary Affairs

Brian F. Madigan, *Director*

James A. Clouse, *Deputy Director*

Deborah J. Danker, *Deputy Director*

William B. English, *Deputy Director*

Cheryl L. Edwards, *Senior Associate Director*

Andrew T. Levin, *Senior Associate Director*

William Nelson, *Senior Associate Director*

Seth B. Carpenter, *Associate Director*

Roberto Perli, *Associate Director*

Gretchen C. Weinbach, *Deputy Associate Director*

Egon Zakrajsek, *Deputy Associate Director*

Matthew M. Luecke, *Assistant Director*

Stephen A. Meyer, *Senior Adviser*

1. The designations as Chairman and Vice Chairman expire on January 31, 2010, and June 22, 2010, respectively, unless the service of these members of the Board terminates sooner.

Board of Governors—continued

Division of Research and Statistics

David J. Stockton, *Director*
David W. Wilcox, *Deputy Director*
J. Nellie Liang, *Senior Associate Director*
David L. Reifschneider, *Senior Associate Director*
Lawrence Slifman, *Senior Associate Director*
William L. Wascher III, *Senior Associate Director*
Alice Patricia White, *Senior Associate Director*
Michael S. Gibson, *Associate Director*
S. Wayne Passmore, *Associate Director*
Janice Shack-Marquez, *Associate Director*
Daniel E. Sichel, *Associate Director*
Daniel M. Covitz, *Deputy Associate Director*
Michael S. Cringoli, *Deputy Associate Director*
Matthew J. Eichner, *Deputy Associate Director*
Diana Hancock, *Deputy Associate Director*
David E. Lebow, *Deputy Associate Director*
Michael G. Palumbo, *Deputy Associate Director*
Joyce K. Zickler, *Deputy Associate Director*
Sean D. Campbell, *Assistant Director*
Sandra A. Cannon, *Assistant Director*
Eric M. Engen, *Assistant Director*
Joshua Gallin, *Assistant Director*
Michael T. Kiley, *Assistant Director*
Andreas Lehnert, *Assistant Director*
Robin A. Prager, *Assistant Director*
Mary M. West, *Assistant Director*
Glenn B. Canner, *Senior Adviser*
Stephen D. Oliner, *Senior Adviser*

Division of Banking Supervision and Regulation

Patrick M. Parkinson, *Director*
Norah M. Barger, *Deputy Director*
Peter J. Purcell, *Deputy Director*
Barbara J. Bouchard, *Associate Director*
Betsy Cross, *Associate Director*
Gerald A. Edwards, Jr., *Associate Director*
Jon D. Greenlee, *Associate Director*
Jack P. Jennings II, *Associate Director*
David S. Jones, *Associate Director*
Arthur W. Lindo, *Associate Director*
William C. Schneider, Jr., *Associate Director*
William G. Spaniel, *Associate Director*
Coryann Stefansson, *Associate Director*
Molly S. Wassom, *Associate Director*
Kevin M. Bertsch, *Deputy Associate Director*
James A. Embersit, *Deputy Associate Director*
Philip Aquilino, *Assistant Director*
Robert T. Ashman, *Assistant Director*
Lisa M. DeFerrari, *Assistant Director*
Adrienne T. Haden, *Assistant Director*
Robert T. Maahs, *Assistant Director*
Richard A. Naylor II, *Assistant Director*
Nina A. Nichols, *Assistant Director*
Dana E. Payne, *Assistant Director*
Nancy J. Perkins, *Assistant Director*
Sabeth I. Siddique, *Assistant Director*
Sarkis Yoghourtdjian, *Assistant Director*
Timothy P. Clark, *Senior Adviser*
Nida Davis, *Senior Adviser*
Michael R. Foley, *Senior Adviser*
Charles H. Holm, *Senior Adviser*
Kevin J. Clarke, *Adviser*
William F. Treacy, *Adviser*

Division of Consumer and Community Affairs

Sandra F. Braunstein, *Director*
Glenn E. Loney, *Deputy Director*
Anna Alvarez-Boyd, *Associate Director*
Leonard Chanin, *Associate Director*
Tonda E. Price, *Associate Director*
Timothy R. Burniston, *Assistant Director*
Joseph Firschein, *Assistant Director*
Allen J. Fishbein, *Assistant Director*
Suzanne G. Killian, *Assistant Director*

Board of Governors—continued

James A. Michaels, *Assistant Director*
Maryann F. Hunter, *Senior Adviser*

Division of Reserve Bank Operations and Payment Systems

Louise L. Roseman, *Director*
Donald V. Hammond, *Deputy Director*
Jeffrey C. Marquardt, *Deputy Director*
Kenneth D. Buckley, *Associate Director*
Dorothy LaChapelle, *Associate Director*
Jeff J. Stehm, *Associate Director*
Gregory L. Evans, *Deputy Associate Director*
Susan V. Foley, *Deputy Associate Director*
Lisa K. Hoskins, *Deputy Associate Director*
Michael J. Lambert, *Assistant Director*
Michael J. Stan, *Assistant Director*
Leonard J. Tanis, *Assistant Director*
Paul W. Bettge, *Senior Adviser*

Office of Staff Director for Management

Stephen R. Malphrus, *Staff Director for Management*
Charles S. Struckmeyer, *Deputy Staff Director*
Sheila Clark, *Equal Employment Opportunity Programs Director*
Lynn S. Fox, *Senior Adviser*
Adrienne D. Hurt, *Adviser*

Management Division

H. Fay Peters, *Director*
Donald A. Spicer, *Deputy Director*
Michell C. Clark, *Deputy Director*
Todd A. Glissman, *Senior Associate Director*
William L. Mitchell, *Senior Associate Director*
Billy J. Sauls, *Senior Associate Director*
Christine M. Fields, *Associate Director*
James R. Riesz, *Associate Director*
Marie S. Savoy, *Associate Director*
Elaine M. Boutilier, *Deputy Associate Director*
Charles F. O'Malley, *Deputy Associate Director*
Tara C. Tinsley-Pelitere, *Deputy Associate Director*
Keith F. Bates, *Assistant Director*
Jeffrey R. Peirce, *Assistant Director*
Theresa A. Trimble, *Assistant Director*
Karen L. Vassallo, *Assistant Director*
Carol A. Sanders, *Special Adviser*
Christopher J. Suma, *Special Adviser*

Division of Information Technology

Maureen T. Hannan, *Director*
Geary L. Cunningham, *Deputy Director*
Wayne A. Edmondson, *Deputy Director*
Sharon L. Mowry, *Deputy Director*
Po Kyung Kim, *Deputy Associate Director*
Susan F. Marycz, *Deputy Associate Director*
Raymond Romero, *Deputy Associate Director*
Lisa M. Bell, *Assistant Director*
Glenn S. Eskow, *Assistant Director*
Kofi A. Sapong, *Assistant Director*
Rajasekhar R. Yelisetty, *Assistant Director*
Tillena G. Clark, *Adviser*

Office of Inspector General

Elizabeth A. Coleman, *Inspector General*
Anthony J. Castaldo, *Assistant Inspector General*
Laurence A. Froehlich, *Assistant Inspector General*
Andrew Patchan, *Jr., Assistant Inspector General*
Harvey Witherspoon, *Assistant Inspector General*

Federal Open Market Committee

December 31, 2009

Members

Ben S. Bernanke, *Chairman,* Board of Governors

William C. Dudley, *Vice Chairman,* President, Federal Reserve Bank of New York

Elizabeth A. Duke, Board of Governors

Charles L. Evans, *President,* Federal Reserve Bank of Chicago

Donald L. Kohn, Board of Governors

Jeffrey M. Lacker, *President,* Federal Reserve Bank of Richmond

Dennis P. Lockhart, *President,* Federal Reserve Bank of Atlanta

Daniel K. Tarullo, Board of Governors

Kevin M. Warsh, Board of Governors

Janet L. Yellen, *President,* Federal Reserve Bank of San Francisco

Alternate Members

Christine M. Cumming, *First Vice President,* Federal Reserve Bank of New York

Jim Bullard, *President,* Federal Reserve Bank of St. Louis

Sandra Pianalto, *President,* Federal Reserve Bank of Cleveland

Eric S. Rosengren, *President,* Federal Reserve Bank of Boston

Thomas M. Hoenig, *President,* Federal Reserve Bank of Kansas City

Officers

Brian F. Madigan, *Secretary and Economist*

Matthew M. Luecke, *Assistant Secretary*

David W. Skidmore, *Assistant Secretary*

Michelle A. Smith, *Assistant Secretary*

Scott G. Alvarez, *General Counsel*

Thomas C. Baxter, Jr., *Deputy General Counsel*

Richard M. Ashton, *Assistant General Counsel*

D. Nathan Sheets, *Economist*

David J. Stockton, *Economist*

David E. Altig, *Associate Economist*

James A. Clouse, *Associate Economist*

Thomas A. Connors, *Associate Economist*

Steven B. Kamin, *Associate Economist*

Lawrence Slifman, *Associate Economist*

Daniel G. Sullivan, *Associate Economist*

Joseph S. Tracy, *Associate Economist*

John A. Weinberg, *Associate Economist*

David W. Wilcox, *Associate Economist*

John C. Williams, *Associate Economist*

Brian Sack, *Manager, System Open Market Account*

The Federal Open Market Committee is made up of the seven members of the Board of Governors; the president of the Federal Reserve Bank of New York; and four of the remaining eleven Reserve Bank presidents, who serve one-year terms on a rotating basis. During 2009 the Federal Open Market Committee held eight regularly scheduled meetings and three conference calls (see "Minutes of Federal Open Market Committee Meetings" in this volume).

Federal Advisory Council

December 31, 2009

Members

District 1—Ellen Alemany, *Chairman and Chief Executive Officer*, RBS Americas/Citizens Financial Group, Greenwich, Conn.

District 2—Robert P. Kelly, *Chairman and Chief Executive Officer*, The Bank of New York Mellon, New York, N.Y.

District 3—R. Scott Smith, Jr. *Chairman, President, and Chief Executive Officer*, Fulton Financial Corporation, Lancaster, PA

District 4—Henry L. Meyer III, *Chairman, President, and Chief Executive Officer*, KeyCorp, Cleveland, Ohio

District 5—Kenneth D. Lewis, *Chief Executive Officer and President*, Bank of America Corporation, Charlotte, N.C.

District 6—Richard G. Hickson, *Chairman and Chief Executive Officer*, Trustmark Corporation, Jackson, Miss.

District 7—William A. Downe, *President and Chief Executive Officer*, Bank of Montreal, Chicago, Ill.

District 8—Lewis F. Mallory, Jr., *Chairman and Chief Executive Officer*, Cadence Financial Corporation, Starkville, Miss.

District 9—Richard K. Davis, *Chairman, President, and Chief Executive Officer*, U.S. Bancorp, Minneapolis, MN

District 10—Bruce R. Lauritzen, *Chairman*, First National Bank of Omaha, Omaha, NE

District 11—Richard W. Evans, Jr., *Chairman and Chief Executive Officer*, Cullen/Frost Bankers Inc., San Antonio, TX

District 12—Russell Goldsmith, *Chairman and Chief Executive Officer*, City National Bank, Beverly Hills, Calif.

Officers

William A. Downe, *President*

R. Scott Smith, Jr., *Vice President*

James E. Annable, *Secretary*

The Federal Advisory Council—a statutory body established under the Federal Reserve Act—consults with, and advises, the Board of Governors on all matters within the Board's jurisdiction. It is composed of one representative from each Federal Reserve District, chosen by the Reserve Bank in that District. The Federal Reserve Act requires the council to meet in Washington, D.C., at least four times a year. In 2009, it met on February 5–6, April 30, May 1, September 10–11, and December 3–4. The council met with the Board on February 6, May 1, September 11, and December 4, 2009.

Consumer Advisory Council

December 31, 2009

Members

PAULA BRYANT-ELLIS, *Senior Vice President,* Community Development Banking Group, BOK Financial Corporation, Tulsa, Okla.

ALAN CAMERON, *President and Chief Executive Officer,* Idaho Credit Union League, Boise, Idaho

JOHN P. CAREY, *Chief Administrative Officer,* Consumer Banking, North America, Citigroup, New York, N.Y.

JASON ENGEL, *Vice President and Chief Regulatory Counsel,* Experian, Costa Mesa, Calif.

KATHLEEN ENGEL, *Professor of Law,* Suffolk University Law School, Boston, Mass.

JOSEPH FALK, *Consultant,* Akerman Senterfitt, Miami, Fla.

CAROLYN "BETSY" FLYNN, *President and Vice Chairman,* Community Financial Services Bank, Benton, Ky.

PATRICIA GARCIA DUARTE, *President and Chief Executive Officer,* Neighborhood Housing Services of Phoenix, Phoenix, Ariz.

LOUISE GISSENDANER, *Senior Vice President, Director of Community Development,* Fifth Third Bank, Cleveland, Ohio

IRA GOLDSTEIN, *Director, Policy and Information Services,* The Reinvestment Fund, Philadelphia, Pa.

GRETA HARRIS, *Vice President—Southeast Region,* Local Initiatives Support Corporation, Richmond, Va.

PATRICIA A. HASSON, *President,* Consumer Credit Counseling Service of Delaware Valley, Inc., Philadelphia, Pa.

THOMAS P. JAMES, *Senior Assistant Attorney General-Consumer Counsel,* Office of the Illinois Attorney General, Consumer Fraud Bureau, Chicago, Ill.

KIRSTEN KEEFE, *Senior Staff Attorney,* Empire Justice Center, Albany, N.Y.

LORENZO LITTLES, *Dallas Director,* Enterprise Community Partners, Inc., Dallas, Texas

LARRY B. LITTON, JR., *President and Chief Executive Officer,* Litton Loan Servicing LP, Houston, Texas

SAURABH NARAIN, *Chief Fund Advisor,* National Community Investment Fund, Chicago, Ill.

ANDY NAVARRETE, *Senior Vice President, Chief Counsel—National Lending,* Capital One Financial Corporation, McLean, Va.

JIM PARK, *President and Chief Executive Officer,* New Vista Asset Management, San Diego, Calif.

RONALD PHILLIPS, *President,* Coastal Enterprises, Inc., Wiscasset, Maine

KEVIN RHEIN, *Division President,* Wells Fargo Card Services, Minneapolis, Minn.

SHANNA SMITH, *President and Chief Executive Officer,* National Fair Housing Alliance, Washington, D.C.

H. COOKE SUNOO, *Director,* Asian Pacific Islander Small Business Program, Los Angeles, Calif.

JENNIFER TESCHER, *Director,* Center for Financial Services Innovation, Chicago, Ill.

STERGIOS "TERRY" THEOLOGIDES, *Executive Vice President, General Counsel,* Saxon Mortgage, Irving, Texas

MARY TINGERTHAL, *President,* Capital Markets Companies, Housing Partnership Network, St. Paul, Minn.

LINDA TINNEY, *Vice President,* Community Development, West Metro Region Manager, U.S. Bank, Denver, Colo.

LUZ URRUTIA, *Chief Executive Officer and President,* El Banco de Nuestra Comunidad, Roswell, Ga.

Officers

EDNA SAWADY, *Council Chair, Economic Inclusion Consultant,* New York, N.Y.

MICHAEL CALHOUN, *Council Vice Chair, President,* Center for Responsible Lending, Durham, N.C.

The Consumer Advisory Council—a statutory body established pursuant to the 1976 amendments to the Equal Credit Opportunity Act—advises the Board of Governors on consumer financial services. Its members, who are appointed by the Board, are academics, state and local government officials, and representatives of the financial services industry and of consumer and community interests. In 2009, the Council met with the Board on March 26, June 18, and October 22.

Thrift Institutions Advisory Council

December 31, 2009

Members

F. Edward Broadwell, Jr., *Chairman and Chief Executive Officer*, HomeTrust Bank, Asheville, N.C.

Barrie G. Christman, *Chairman,* Principal Bank, Des Moines, Iowa

William A. Donius, *Board Director*, Pulaski Financial Corp., St. Louis, Mo.

Joseph R. Ficalora, *Chairman, President, and Chief Executive Officer,* New York Community Bancorp, Westbury, N.Y.

Curtis L. Hage, *Chairman and Chief Executive Officer*, Home Federal Bank, Sioux Falls, S.D.

Christopher T. Jillson, *President and Chief Executive Officer*, Sandia Laboratory Federal Credit Union, Albuquerque, N.M.

Peter L. Judkins, *President and Chief Executive Officer*, Franklin Savings Bank, Farmington, Maine

Richard J. Green, *Chief Executive Officer,* Firstrust Bank, Conshohocken, Pa.

Richard G. Harwood, *President and Chief Executive Officer,* Newport Federal Bank, Newport, Tenn.

Kay M. Hoveland, *President and Chief Executive Officer,* Kaiser Federal Bank and K-Fed Bancorp, Covina, Calif.

Randy M. Smith, *Chief Executive Officer and President,* Randolph–Brooks Federal Credit Union, Universal City, Texas

William R. White, *Chairman and Chief Executive Officer,* Dearborn Federal Savings Bank, Dearborn, Mich.

Officer

Curtis L. Hage, *President*

The Thrift Institutions Advisory Council was established by the Board of Governors to consult with, and advise, the Board on issues pertaining to the thrift industry and on other matters within the Board's jurisdiction. Its members, who are appointed by the Board, represent credit unions, savings and loan associations, and savings banks. In 2009, the council met with the Board on February 20, June 26, and December 18.

Federal Reserve Banks and Branches

December 31, 2009

Officers

BANK or Branch	Chair[1] Deputy Chair	President First Vice President	Officer in charge of Branch
BOSTON[2]	Lisa M. Lynch Henri A. Termeer	Eric S. Rosengren Paul M. Connolly	
NEW YORK[2]	Denis M. Hughes Lee C. Bollinger	William C. Dudley Christine M. Cumming	
PHILADELPHIA	William F. Hecht Charles P. Pizzi	Charles I. Plosser William H. Stone, Jr.	
CLEVELAND	Tanny B. Crane Alfred M. Rankin, Jr.	Sandra Pianalto Vacant	
Cincinnati	James M. Anderson		LaVaughn M. Henry
Pittsburgh	Sunil T. Wadhwani		Robert B. Schaub
RICHMOND	Lemuel E. Lewis Margaret E. McDermid	Jeffrey M. Lacker Sarah G. Green	
Baltimore	William R. Roberts		David E. Beck
Charlotte	Claude C. Lilly		Matthew A. Martin
ATLANTA	D. Scott Davis Carol B. Tomé	Dennis P. Lockhart Patrick K. Barron	
Birmingham	F. Michael Reilly		Julius Weyman
Jacksonville	Linda H. Sherrer		Christopher L. Oakley
Miami	Gay Rebel Thompson		Juan del Busto
Nashville	David Williams II		Lee C. Jones
New Orleans	Robert S. Boh		Robert J. Musso
CHICAGO[2]	John A. Canning, Jr. William C. Foote	Charles L. Evans Gordon Werkema	
Detroit	Timothy M. Manganello		Robert Wiley
ST. LOUIS	Steven H. Lipstein Ward M. Klein	James Bullard David A. Sapenaro	
Little Rock	Sonja Yates Hubbard		Robert A. Hopkins
Louisville	Gary A. Ransdell		Maria Gerwing Hampton
Memphis	Charles S. Blatteis		Martha Perine Beard
MINNEAPOLIS	James J. Hynes John W. Marvin	Narayana R. Kocherlakota James M. Lyon	
Helena	Joseph F. McDonald		R. Paul Drake

Officers—continued

BANK or Branch	Chair[1] Deputy Chair	President First Vice President	Officer in charge of Branch
KANSAS CITY	Lu M. Cordova Paul DeBruce	Thomas M. Hoenig Esther L. George	
Denver	Kristy A. Schloss		Mark C. Snead
Oklahoma City	Steven C. Agee		Chad Wilkerson
Omaha	Charles R. Hermes		Jason Henderson
DALLAS	James T. Hackett Herb Kelleher	Richard W. Fisher Helen E. Holcomb	
El Paso	D. Kirk Edwards		Robert W. Gilmer
Houston	Douglas L. Foshee		Robert Smith III
San Antonio	Steven R. Vandegrift		Blake Hastings
SAN FRANCISCO[2]	T. Gary Rogers Douglas W. Shorenstein	Janet L. Yellen John F. Moore	
Los Angeles	Andrew J. Sale		Mark L. Mullinix
Portland	James H. Rudd		Steven H. Walker
Salt Lake City	Clark D. Ivory		Robin A. Rockwood
Seattle	Helvi K. Sandvik		Mark A. Gould

1. The chair of a Federal Reserve Bank serves, by statute, as Federal Reserve agent.
2. Additional offices of these Banks are located at Windsor Locks, Connecticut; East Rutherford, New Jersey; Des Moines, Iowa; Midway at Bedford Park, Illinois; and Phoenix, Arizona.

Conference of Chairs

The chairs of the Federal Reserve Banks are organized into the Conference of Chairs, which meets to consider matters of common interest and to consult with and advise the Board of Governors. Such meetings, also attended by the deputy chairs, were held in Washington, D.C., on May 19 and 20; September 21; and November 17 and 18, 2009.

The members of the executive committee of the Conference of Chairs during 2009 were Lisa M. Lynch, chair; Lemuel E. Lewis, vice chair; and James J. Hynes, member.

On November 18, the conference elected its executive committee for 2010, naming Lemuel E. Lewis as chair; Charles P. Pizzi as vice chair; and Alfred M. Rankin, Jr. as the third member.

Conference of Presidents

The presidents of the Federal Reserve Banks are organized into the Conference of Presidents, which meets periodically to identify, define, and deliberate issues of strategic significance to the Federal Reserve System; to consider matters of common interest; and to consult with and advise the Board of Governors.

Jeffrey M. Lacker, president of the Federal Reserve Bank of Richmond, served as chair of the conference in 2009, and Richard W. Fisher, president of the Federal Reserve Bank of Dallas, served as vice chair. Sandra Tormoen, Federal Reserve Bank of Richmond, served as secretary, and Harvey Mitchell, Federal Reserve Bank of Dallas, served as assistant secretary.

Conference of First Vice Presidents

The Conference of First Vice Presidents of the Federal Reserve Banks was organized in 1969 to meet periodically for the consideration of operations and other matters.

James M. Lyon, first vice president of the Federal Reserve Bank of Minneapolis, served as chair of the conference in 2009, and Sheryl L. Britsch, Federal Reserve Bank of Minneapolis, served as secretary. The conference ratified the appointment of Sally Green, first vice president of the Federal Reserve Bank of Richmond, as vice chair for the remainder of 2009 after the death of R. Chris Moore, first vice president of the Federal Reserve Bank of Cleveland and vice chair of the conference for 2008-09. Anne C. Gossweiler, Federal Reserve Bank of Richmond, was also appointed to succeed Diana C. Starks, Federal Reserve Bank of Cleveland, as assistant secretary for the remainder of 2009. Those actions were effective February 18, 2009.

On October 21, 2009, the conference ratified the appointment of Sally Green as chair, Esther L. George, first vice president of the Federal Reserve Bank of Kansas City, as vice chair, and Anne C. Gossweiler as secretary for 2010–11.

Directors

Each Federal Reserve Bank has a nine member board: three Class A and three Class B directors, who are elected by the stockholding member banks, and three Class C directors, who are appointed by the Board of Governors.

Class A directors represent the stockholding member banks in each Federal Reserve District. Class B and Class C directors represent the public and are chosen with due, but not exclusive, consideration to the interests of agriculture, commerce, industry, services, labor, and consumers; they may not be officers, directors, or employees of any bank or bank holding company. In addition, Class C directors may not be stockholders of any bank or bank holding company.

For the election of Class A and Class B directors, the member banks of each Federal Reserve District are classified into three groups. Each group, which comprises banks with similar capitalization, elects one Class A director and one Class B director. Annually, the Board of Governors designates one of the Class C directors as chair of the board and Federal Reserve agent of each District Bank, and it designates another Class C director as deputy chair.

Federal Reserve Branches have either five or seven directors, a majority of whom are appointed by the parent Federal Reserve Bank; the others are appointed by the Board of Governors. One of the directors appointed by the Board is designated annually as chair of the board of that Branch in a manner prescribed by the parent Federal Reserve Bank.

The chairs and deputy chairs of the Reserve Bank boards of directors, and the chairs of the Branches, are listed in the preceding table, titled “Officers.” The directors of the Banks and Branches are listed in the following table. For each director, the class of directorship, the director’s principal organizational affiliation, and the date the director’s term expires are shown.

Directors

December 31, 2009

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
	DISTRICT 1—BOSTON	
Reserve Bank		
Class A		
David A. Lentini	Chairman, President, and Chief Executive Officer, The Connecticut Bank and Trust Company, Hartford, Connecticut	2009
James C. Smith	Chairman and Chief Executive Officer, Webster Bank, N.A., Waterbury, Connecticut	2010
Kathryn G. Underwood	President and Chief Executive Officer, Ledyard National Bank, Hanover, New Hampshire	2011
Class B		
Stuart H. Reese	Chairman and Chief Executive Officer, MassMutual Financial Group, Springfield, Massachusetts	2009
Robert K. Kraft	Chairman and Chief Executive Officer, The Kraft Group, Foxborough, Massachusetts	2010
Michael T. Wedge	Former President and Chief Executive Officer, BJ's Wholesale Club, Inc., Natick, Massachusetts	2011
Class C		
Lisa M. Lynch	Dean and Professor of Economics, The Heller School for Social Policy and Management, Brandeis University, Waltham, Massachusetts	2009
Kirk A. Sykes	President, Urban Strategy America Fund, L.P., Boston, Massachusetts	2010
Henri A. Termeer	Chairman, President, and Chief Executive Officer, Genzyme Corporation, Cambridge, Massachusetts	2011
	DISTRICT 2—NEW YORK	
Reserve Bank		
Class A		
James Dimon	Chairman and Chief Executive Officer, JPMorgan Chase & Co., New York, New York	2009
Richard L. Carrión	Chairman, President and Chief Executive Officer, Popular, Inc., San Juan, Puerto Rico	2010
Charles V. Wait	President, Chief Executive Officer, and Chairman, The Adirondack Trust Company, Saratoga Springs, New York	2011
Class B		
Jeffrey B. Kindler	Chairman and Chief Executive Officer, Pfizer, Inc., New York, New York	2009
James S. Tisch	President and Chief Executive Officer, Loews Corporation, New York, New York	2010
Jeffrey R. Immelt	Chairman and Chief Executive Officer, General Electric Company, Fairfield, Connecticut	2011

Directors—continued

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
Class C		
Lee C. Bollinger	President, Columbia University, New York, New York	2009
Kathryn S. Wylde	President and Chief Executive Officer, Partnership for New York City, New York, New York	2010
Denis M. Hughes	President, New York State AFL-CIO, New York, New York	2011
	DISTRICT 3—PHILADELPHIA	
Reserve Bank		
Class A		
Aaron L. Groff, Jr.	Chairman, President, and Chief Executive Officer, Ephrata National Bank, Ephrata, Pennsylvania	2009
Ted T. Cecala	Chairman and Chief Executive Officer, Wilmington Trust Corporation, Wilmington, Delaware	2010
Frederick C. Peters	Chairman and Chief Executive Officer, Bryn Mawr Trust Company, Bryn Mawr, Pennsylvania	2011
Class B		
Garry L. Maddox	President and Chief Executive Officer, A. Pomerantz & Company, Philadelphia, Pennsylvania	2009
Keith S. Campbell	Chairman, Mannington Mills, Inc., Salem, New Jersey	2010
Michael F. Camardo	Retired Executive Vice President, Lockheed Martin ITS, Cherry Hill, New Jersey	2011
Class C		
William F. Hecht	Retired Chairman, President, and Chief Executive Officer, PPL Corporation, Allentown, Pennsylvania	2009
Jeremy Nowak	President and Chief Executive Officer, The Reinvestment Fund, Philadelphia, Pennsylvania	2010
Charles P. Pizzi	President and Chief Executive Officer, Tasty Baking Company, Philadelphia, Pennsylvania	2011
	DISTRICT 4—CLEVELAND	
Reserve Bank		
Class A		
C. Daniel DeLawder	Chairman and Chief Executive Officer, Park National Bank, Newark, Ohio	2009
James E. Rohr	Chairman and Chief Executive Officer, The PNC Financial Services Group, Inc., Pittsburgh, Pennsylvania	2010
Charlotte W. Martin	President and Chief Executive Officer, Great Lakes Bankers Bank, Gahanna, Ohio	2011
Class B		
Susan Tomasky	President, AEP Transmission, Columbus, Ohio	2009
Les C. Vinney	Senior Advisor and Immediate Past President and Chief Executive Officer, STERIS Corporation, Mentor, Ohio	2010
Tilmon F. Brown	President and Chief Executive Officer, New Horizons Baking Company, Norwalk, Ohio	2011

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
Class C		
Tanny B. Crane	President and Chief Executive Officer, Crane Group Company, Columbus, Ohio	2009
Roy W. Haley	Chairman and Chief Executive Officer, WESCO International, Inc., Pittsburgh, Pennsylvania	2010
Alfred M. Rankin, Jr.	Chairman, President, and Chief Executive Officer, NACCO Industries, Inc., Cleveland, Ohio	2011
Cincinnati Branch		
Appointed by the Federal Reserve Bank		
Donald E. Bloomer	President and Chief Executive Officer, Citizens National Bank, Somerset, Kentucky	2009
Paul R. Poston	Director, Great Lakes District, NeighborWorks® America, Cincinnati, Ohio	2010
Gregory B. Kenny	President and Chief Executive Officer, General Cable Corporation, Highland Heights, Kentucky	2011
Janet B. Reid	Principal Partner, Global Lead Management Consulting, Cincinnati, Ohio	2011
Appointed by the Board of Governors		
Daniel B. Cunningham	President and Chief Executive Officer, Long-Stanton Manufacturing Companies, Cincinnati, Ohio	2009
Peter S. Strange	Chairman and Chief Executive Officer, Messer Construction Company, Cincinnati, Ohio	2010
James M. Anderson	President and Chief Executive Officer, Cincinnati Children's Hospital Medical Center, Cincinnati, Ohio	2011
Pittsburgh Branch		
Appointed by the Federal Reserve Bank		
Margaret Irvine Weir	President, NexTier Bank, Butler, Pennsylvania	2009
Todd D. Brice	Chief Executive Officer, S&T Bancorp, Inc., Indiana, Pennsylvania	2010
Howard W. Hanna III	Chairman and Chief Executive Officer, Howard Hanna Real Estate Services, Pittsburgh, Pennsylvania	2011
Petra Mitchell	President, Catalyst Connection, Pittsburgh, Pennsylvania	2011
Appointed by the Board of Governors		
Robert A. Paul	Chairman and Chief Executive Officer, Ampco–Pittsburgh Corporation, Pittsburgh, Pennsylvania	2009
Glenn R. Mahone	Partner and Attorney at Law, Reed Smith LLP, Pittsburgh, Pennsylvania	2010
Sunil T. Wadhwani	Co-Chairman, iGATE Corporation, Pittsburgh, Pennsylvania	2011

Directors—continued

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
	DISTRICT 5—RICHMOND	
Reserve Bank		
Class A		
Dwight V. Neese	Director, President, and Chief Executive Officer, Provident Community Bank and Provident Community Bancshares, Inc., Rock Hill, South Carolina	2009
Robert H. Gilliam, Jr.	President and Chief Executive Officer, First National Bank, Altavista, Virginia	2010
Kelly S. King	Chief Executive Officer, BB&T Corporation, Winston-Salem, North Carolina	2011
Class B		
Kenneth R. Sparks	President and Chief Executive Officer, Ken Sparks Associates LLC, White Stone, Virginia	2009
Patrick C. Graney, III	President, Petroleum Products, Inc., Belle, West Virginia	2010
Dana S. Boole	President and Chief Executive Officer, Community Affordable Housing Equity Corporation, Raleigh, North Carolina	2011
Class C		
Lemuel E. Lewis	President, LocalWeather.com, Suffolk, Virginia	2009
Margaret E. McDermid	Senior Vice President and Chief Information Officer, Dominion Resources, Inc., Richmond, Virginia	2010
Linda D. Rabbitt	Chairman and Chief Executive Officer, Rand Construction Corporation, Alexandria, Virginia	2011
Baltimore Branch		
Appointed by the Federal Reserve Bank		
James T. Brady	Managing Director-Mid-Atlantic, Ballantrae International, Ltd., Ijamsville, Maryland	2009
Michael L. Middleton	Chairman and President, Community Bank of Tri-County, Waldorf, Maryland	2009
William B. Grant	Chairman and Chief Executive Officer, First United Corp. and First United Bank & Trust, Oakland, Maryland	2010
Biana J. Arentz	President and Chief Executive Officer, Hemingway's Inc., Stevensville, Maryland	2011
Appointed by the Board of Governors		
Ronald Blackwell	Chief Economist, AFL-CIO, Washington, D.C.	2009
William R. Roberts	President–Verizon Maryland/DC, Verizon Maryland Inc., Baltimore, Maryland	2010
Jenny G. Morgan	President, basys, inc., Linthicum, Maryland	2011

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
Charlotte Branch *Appointed by the* *Federal Reserve Bank*		
John S. Kreighbaum	President and Chief Executive Officer, Carolina Premier Bank, Charlotte, North Carolina	2009
Michael C. Miller	President and Chief Executive Officer, FNB United Corp. and CommunityONE Bank, N.A., Asheboro, North Carolina	2009
Barry L. Slider	President and Chief Executive Officer, First South Bancorp, Inc. and First South Bank, Spartanburg, South Carolina	2010
James H. Speed, Jr.	President and Chief Executive Officer, North Carolina Mutual Life Insurance Company, Durham, North Carolina	2011
Appointed by the *Board of Governors*		
David J. Zimmerman	President, Southern Shows, Inc., Charlotte, North Carolina	2009
Claude C. Lilly	Dean, Clemson University, College of Business and Behavioral Science, Clemson, South Carolina	2010
Linda L. Dolny	President, PML Associates, Inc., Greenwood, South Carolina	2011
	DISTRICT 6—ATLANTA	
Reserve Bank *Class A*		
Rudy E. Schupp	President and Chief Executive Officer, 1st United Bank, West Palm Beach, Florida	2009
T. Anthony Humphries	President and Chief Executive Officer, NobleBank and Trust, N.A., Anniston, Alabama	2010
James M. Wells III	Chairman and Chief Executive Officer, SunTrust Banks, Inc., Atlanta, Georgia	2011
Class B		
Teri G. Fontenot	President and Chief Executive Officer, Woman's Hospital, Baton Rouge, Louisiana	2009
Lee M. Thomas	Chairman, President and Chief Executive Officer, Rayonier, Jacksonville, Florida	2010
Renée Lewis Glover	President and Chief Executive Officer, Atlanta Housing Authority, Atlanta, Georgia	2011
Class C		
D. Scott Davis	Chairman and Chief Executive Officer, United Parcel Service, Atlanta, Georgia	2009
Carol B. Tomé	Chief Financial Officer and Executive Vice President, The Home Depot, Atlanta, Georgia	2010
Thomas I. Barkin	Director, McKinsey & Company, Atlanta, Georgia	2011
Birmingham Branch *Appointed by the* *Federal Reserve Bank*		
Bobby A. Bradley	Managing Partner, Lewis Properties, LLC and Anderson Investments, LLC, Huntsville, Alabama	2009

Directors—continued

BANK OR BRANCH, *Category* Name	Title	Term expires Dec. 31
Samuel F. Dodson	Consultant, International Union of Operating Engineers – Local 312, Birmingham, Alabama	2009
C. Richard Moore, Jr.	Chairman, President and Chief Executive Officer, Peoples Southern Bank, Clanton, Alabama	2010
Macke B. Mauldin	President, Bank Independent, Sheffield, Alabama	2011
Appointed by the Board of Governors		
F. Michael Reilly	Chairman, President and Chief Executive Officer, Randall-Reilly Publishing Co., LLC, Tuscaloosa, Alabama	2009
Maryam B. Head	Chairman, Ram Tool and Supply Company, Inc., Birmingham, Alabama	2010
Thomas R. Stanton	Chairman and Chief Executive Officer, ADTRAN, Inc., Huntsville, Alabama	2011
JACKSONVILLE BRANCH		
Appointed by the Federal Reserve Bank		
Wendell A. Sebastian	President and Chief Executive Officer, GTE Federal Credit Union, Tampa, Florida	2009
Ellen S. Titen	President, E.T. Consultants, Winter Park, Florida	2009
Jack B. Healan, Jr.	President, Amelia Island Company, Amelia Island, Florida	2010
Hugh F. Dailey	President and Chief Executive Officer, Community Bank & Trust of Florida, Ocala, Florida	2011
Appointed by the Board of Governors		
Linda H. Sherrer	President and Chief Executive Officer, Prudential Network Realty, Jacksonville, Florida	2009
H. Britt Landrum, Jr.	President and Chief Executive Officer, Landrum Human Resource Companies, Inc., Pensacola, Florida	2010
Lynda L. Weatherman	President and Chief Executive Officer, Economic Development Commission of Florida's Space Coast, Rockledge, Florida	2011
MIAMI BRANCH		
Appointed by the Federal Reserve Bank		
Leonard L. Abess	Chief Executive Officer, City National Bank of Florida, Miami, Florida	2009
Dennis S. Hudson, III	Chairman and Chief Executive Officer, Seacoast Banking Corporation of Florida, Stuart, Florida	2010
Walter Banks	President, Lago Mar Resort and Club, Fort Lauderdale, Florida	2011
Thomas H. Shea	Chief Executive Officer, Florida/Caribbean Region, Right Management, Fort Lauderdale, Florida	2011

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
Appointed by the Board of Governors		
Eduardo J. Padrón	President, Miami Dade College, Miami, Florida	2009
Gay Rebel Thompson	President and Chief Executive Officer, Cement Industries, Inc., Fort Myers, Florida	2010
W. Cody Estes, Sr.	President, Estes Citrus, Inc., Vero Beach, Florida	2011
Nashville Branch		
Appointed by the Federal Reserve Bank		
Daniel A. Gaudette	Retired Senior Vice President, North American Manufacturing and Supply Chain Management, Nissan North America, Inc., Smyrna, Tennessee	2009
Cordia W. Harrington	President and Chief Executive Officer, Tennessee Bun Company, Nashville, Tennessee	2009
Paul G. Willson	Chairman and Chief Executive Officer, Citizens National Bank, Athens, Tennessee	2010
Dan W. Hogan	President and Chief Executive Officer, Fifth Third Bank, Tennessee, Nashville, Tennessee	2011
Appointed by the Board of Governors		
David Williams II	Vice Chancellor and General Counsel, Vanderbilt University, Nashville, Tennessee	2009
Debra K. London	Retired President and Chief Executive Officer, Mercy Health Partners, Knoxville, Tennessee	2010
Richard Q. Ford	President, Hylant Group of Nashville, Nashville, Tennessee	2011
New Orleans Branch		
Appointed by the Federal Reserve Bank		
Matthew G. Stuller, Sr.	Chairman and Chief Executive Officer, Stuller, Inc., Lafayette, Louisiana	2009
Anthony J. Topazi	President and Chief Executive Officer, Mississippi Power, Gulfport, Mississippi	2009
Gerard R. Host	President and Chief Operating Officer, Trustmark National Bank, Jackson, Mississippi	2010
R. King Milling	Member, Board of Directors, Whitney Holding Corporation and Whitney National Bank, New Orleans, Louisiana	2011
Appointed by the Board of Governors		
Robert S. Boh	President and Chief Executive Officer, Boh Bros. Construction Co., LLC, New Orleans, Louisiana	2009
Christel C. Slaughter	Partner, SSA Consultants, LLC, Baton Rouge, Louisiana	2010
José S. Suquet	Chairman, President and Chief Executive Officer, Pan-American Life Insurance Group, New Orleans, Louisiana	2011

Directors—continued

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
	DISTRICT 7—CHICAGO	
Reserve Bank		
Class A		
Michael L. Kubacki	Chairman, President, and Chief Executive Officer, Lakeland Financial Corporation, Warsaw, Indiana	2009
Mark C. Hewitt	President and Chief Executive Officer, Clear Lake Bank & Trust Company, Clear Lake, Iowa	2010
Frederick H. Waddell	Chairman, President and Chief Executive Officer, Northern Trust Corporation and The Northern Trust Company, Chicago, Illinois	2011
Class B		
Mark T. Gaffney	President, Michigan AFL-CIO, Lansing, Michigan	2009
Ann D. Murtlow	President and Chief Executive Officer, Indianapolis Power & Light Company, Indianapolis, Indiana	2010
Anthony K. Anderson	Vice Chair and Midwest Managing Partner, Ernst & Young LLP, Chicago, Illinois	2011
Class C		
William C. Foote	Chairman and Chief Executive Officer, USG Corporation, Chicago, Illinois	2009
Thomas J. Wilson	Chairman, President and Chief Executive Officer, The Allstate Corporation, Northbrook, Illinois	2010
John A. Canning, Jr.	Chairman, Madison Dearborn Partners, LLC, Chicago, Illinois	2011
Detroit Branch		
Appointed by the Federal Reserve Bank		
William R. Hartman	Retired Chairman, Citizens Republic Bancorp, Flint, Michigan	2009
Michael M. Magee, Jr.	President and Chief Executive Officer, Independent Bank Corporation, Ionia, Michigan	2010
Roger A. Cregg	Executive Vice President and Chief Financial Officer, Pulte Homes, Inc., Bloomfield Hills, Michigan	2011
Brian C. Walker	President and Chief Executive Officer, Herman Miller, Inc., Zeeland, Michigan	2011
Appointed by the Board of Governors		
Linda S. Likely	Director of Housing and Community Development, Kent County Community Development Department and Housing Commission, Grand Rapids, Michigan	2009
Carl T. Camden	President and Chief Executive Officer, Kelly Services, Inc., Troy, Michigan	2010
Timothy M. Manganello	Chairman and Chief Executive Officer, BorgWarner Inc., Auburn Hills, Michigan	2011

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
	DISTRICT 8—ST. LOUIS	
Reserve Bank		
Class A		
David R. Pirsein	President and Chief Executive Officer, First National Bank in Pinckneyville, Pinckneyville, Illinois	2009
Robert G. Jones	President and Chief Executive Officer, Old National Bancorp, Evansville, Indiana	2010
J. Thomas May	Chairman and Chief Executive Officer, Simmons First National Corporation, Pine Bluff, Arkansas	2011
Class B		
A. Rogers Yarnell, II	Chairman and Chief Executive Officer, Yarnell Ice Cream Co., Inc., Searcy, Arkansas	2009
Paul T. Combs	President, Baker Implement Company, Kennett, Missouri	2010
Gregory M. Duckett	Senior Vice President and Corporate Counsel, Baptist Memorial Health Care Corporation, Memphis, Tennessee	2011
Class C		
Steven H. Lipstein	President and Chief Executive Officer, BJC HealthCare, St. Louis, Missouri	2009
Sharon D. Fiehler	Executive Vice President and Chief Administrative Officer, Peabody Energy, St. Louis, Missouri	2010
Ward M. Klein	Chief Executive Officer, Energizer Holdings, Inc., St. Louis, Missouri	2011
Little Rock Branch		
Appointed by the Federal Reserve Bank		
William C. Scholl	President and Chief Executive Officer, First Security Bancorp, Little Rock, Arkansas	2009
Sharon Priest	Executive Director, Downtown Little Rock Partnership, Little Rock, Arkansas	2010
Phillip N. Baldwin	President and Chief Executive Officer, Southern Bancorp, Arkadelphia, Arkansas	2011
Robert A. Young, III	Chairman, Arkansas Best Corporation, Fort Smith, Arkansas	2011
Appointed by the Board of Governors		
C. Sam Walls	Chief Executive Officer, Arkansas Capital Corporation, Little Rock, Arkansas	2009
Sonja Yates Hubbard	Chief Executive Officer, E-Z Mart Stores, Inc., Texarkana, Texas	2010
Cal McCastlain	Partner, Pender & McCastlain, P.A., Little Rock, Arkansas	2011

Directors—continued

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
Louisville Branch		
Appointed by the Federal Reserve Bank		
Gordon B. Guess	General Manager, Marion Baseball Club, LLC, Marion, Kentucky	2009
Steven E. Trager	Chairman and Chief Executive Officer, Republic Bank & Trust Company, Louisville, Kentucky	2010
John C. Schroeder	President, Wabash Plastics, Inc., Evansville, Indiana	2011
L. Clark Taylor, Jr.	Chief Executive Officer, Ephraim McDowell Health, Danville, Kentucky	2011
Appointed by the Board of Governors		
Barbara Ann Popp	Chief Executive Officer, Schuler Bauer Real Estate Services, New Albany, Indiana	2009
Gary A. Ransdell	President, Western Kentucky University, Bowling Green, Kentucky	2010
John A. Hillerich, IV	President and Chief Executive Officer, Hillerich & Bradsby Co., Inc., Louisville, Kentucky	2011
Memphis Branch		
Appointed by the Federal Reserve Bank		
David P. Rumbarger, Jr.	President and Chief Executive Officer, Community Development Foundation, Tupelo, Mississippi	2009
Thomas G. Miller	President, Southern Hardware Co., Inc., West Helena, Arkansas	2010
Clyde Warren Nunn	Chairman and President, Security Bancorp of TN, Inc., Halls, Tennessee	2011
Susan S. Stephenson	Co-Chairman and President, Independent Bank, Memphis, Tennessee	2011
Appointed by the Board of Governors		
Nick Clark	Partner, Clark & Clark, Memphis, Tennessee	2009
Charles S. Blatteis	Partner, Burch, Porter & Johnson PLLC, Memphis, Tennessee	2010
Lawrence C. Long	Partner, St. Rest Planting Co., Indianola, Mississippi	2011
	DISTRICT 9—MINNEAPOLIS	
Reserve Bank		
Class A		
Thomas W. Scott	Chairman of the Board, First Interstate BancSystem, Inc., Billings, Montana	2009
James A. Espeland	President and Chief Executive Officer, First National Bank, Henning, Minnesota	2010
Michael J. O'Meara	Chairman, Peoples Bank of Wisconsin, Eau Claire, Wisconsin	2011

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
Class B		
William J. Shorma	President, Shur-Co., Yankton, South Dakota	2009
Todd L. Johnson	Chairman, President, and Chief Executive Officer, Reuben Johnson & Son, Inc. & Affiliated Companies, Superior, Wisconsin	2010
Howard A. Dahl	President and Chief Executive Officer, Amity Technology, LLC, Fargo, North Dakota	2011
Class C		
James J. Hynes	Executive Administrator, Twin City Pipe Trades Service Association, St. Paul, Minnesota	2009
Mary K. Brainerd	President and Chief Executive Officer, HealthPartners, Minneapolis, Minnesota	2010
John W. Marvin	Chairman and Chief Executive Officer, Marvin Windows and Doors, Warroad, Minnesota	2011
Helena Branch		
Appointed by the Federal Reserve Bank		
Timothy J. Bartz	Chief Executive Officer, Anderson ZurMuehlen & Company, P.C., Helena, Montana	2009
Kay Clevidence	President, Farmers State Bank, Victor, Montana	2010
John L. Franklin	President and Chief Executive Officer, 1st Bank, Sidney, Montana	2011
Appointed by the Board of Governors		
Joseph F. McDonald	President, Salish Kootenai College, Pablo, Montana	2009
David B. Solberg	Owner, Seven Blackfoot Ranch Company, Billings, Montana	2011
	DISTRICT 10—KANSAS CITY	
Reserve Bank		
Class A		
Mark W. Schifferdecker	President and Chief Executive Officer, Girard National Bank, Girard, Kansas	2009
Robert C. Fricke	President and Chief Executive Officer, Farmers and Merchants Bank of Ashland, Ashland, Nebraska	2010
John A. Ikard	President and Chief Executive Officer, FirstBank Holding Company, Lakewood, Colorado	2011
Class B		
Vacancy		2009
Mark Gordon	Owner, Merlin Ranch, Buffalo, Wyoming	2010
Richard K. Ratcliffe	Chairman, Ratcliffe's Inc., Weatherford, Oklahoma	2011

Directors—continued

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
Class C		
Paul DeBruce	Chief Executive Officer and Chairman/Founder, DeBruce Grain, Inc., Kansas City, Missouri	2009
Terry L. Moore	President, Omaha Federation of Labor, Omaha, Nebraska	2010
Lu M. Cordova	Chief Executive Officer, Corlund Industries, LLC; President and General Manager, Almacen Storage Group, Boulder, Colorado	2011
Denver Branch		
Appointed by the Federal Reserve Bank		
Charles H. Brown III	President, C.H. Brown Co., Wheatland, Wyoming	2009
John D. Pearson	President, Pearson Real Estate Co., Inc., Buffalo, Wyoming	2009
William C. Enloe	President and Chief Executive Officer, Los Alamos National Bank, Los Alamos, New Mexico	2010
Bruce K. Alexander	President and Chief Executive Officer, Vectra Bank Colorado, Denver, Colorado	2011
Appointed by the Board of Governors		
Barbara Mowry	President and Chief Executive Officer, Silver Creek Systems, Westminster, Colorado	2009
Kristy A. Schloss	President and Chief Executive Officer, Schloss Engineered Equipment, Inc., Aurora, Colorado	2010
Larissa L. Herda	Chairman, Chief Executive Officer, and President, tw telecom inc., Littleton, Colorado	2011
Oklahoma City Branch		
Appointed by the Federal Reserve Bank		
Fred M. Ramos	President, RGF, Inc., Oklahoma City, Oklahoma	2009
Jacqueline R. Fiegel	Senior Executive Vice President and Chief Operating Officer, Coppermark Bank, Oklahoma City, Oklahoma	2010
Douglas E. Tippens	President and Chief Executive Officer, Bank of Commerce, Yukon, Oklahoma	2010
K.Vasudevan	Chairman and Founder, Service & Technology Corporation, Bartlesville, Oklahoma	2011
Appointed by the Board of Governors		
Bill Anoatubby	Governor, Chickasaw Nation, Ada, Oklahoma	2009
Steven C. Agee	President, Agee Energy, LLC, Oklahoma City, Oklahoma	2010
James D. Dunn	Chairman of the Board, Mill Creek Lumber & Supply Company, Tulsa, Oklahoma	2011

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
Omaha Branch		
Appointed by the Federal Reserve Bank		
Todd S. Adams	Chairman and Chief Executive Officer, Adams Bank & Trust, Ogallala, Nebraska	2009
Rodrigo Lopez	President and Chief Executive Officer, AmeriSphere Multifamily Finance, L.L.C., Omaha, Nebraska	2009
JoAnn M. Martin	Chairman, President, and Chief Executive Officer, Ameritas Life Insurance Corp., Lincoln, Nebraska	2010
Mark A. Sutko	President and Chief Executive Officer, Platte Valley State Bank, Kearney, Nebraska	2011
Appointed by the Board of Governors		
Charles R. Hermes	Chief Executive Officer, Dutton-Lainson Company, Hastings, Nebraska	2009
Lyn Wallin Ziegenbein	Executive Director, Peter Kiewit Foundation, Omaha, Nebraska	2010
James C. Farrell	President and Chief Executive Officer, Farmers National Company, Omaha, Nebraska	2011
	DISTRICT 11—DALLAS	
Reserve Bank		
Class A		
Pete Cook	Chief Executive Officer, First National Bank in Alamogordo, Alamogordo, New Mexico	2009
Joe Kim King	Chief Executive Officer and Chairman of the Board, Texas Country Bancshares, Inc., Brady, Texas	2010
George F. Jones, Jr.	Chief Executive Officer, Texas Capital Bank, Dallas, Texas	2011
Class B		
Margaret H. Jordan	President and Chief Executive Officer, Dallas Medical Resource, Dallas, Texas	2009
Robert A. Estrada	Chairman, Estrada Hinojosa & Company, Inc., Dallas, Texas	2010
James B. Bexley	Professor, Finance, Sam Houston State University, Huntsville, Texas	2011
Class C		
Myron E. Ullman III	Chief Executive Officer and Chairman of the Board, J.C. Penney Company, Inc., Plano, Texas	2009
Herb Kelleher	Founder and Chairman Emeritus, Southwest Airlines, Dallas, Texas	2010
James T. Hackett	Chairman, President, and Chief Executive Officer, Anadarko Petroleum Corporation, Houston, Texas	2011
El Paso Branch		
Appointed by the Federal Reserve Bank		
Gerald J. Rubin	Chairman, President, and Chief Executive Officer, Helen of Troy Limited, El Paso, Texas	2009

Directors—continued

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
Larry L. Patton	President and Chief Executive Officer, Bank of the West, El Paso, Texas	2010
Laura M. Conniff	Qualifying Broker, Mathers Realty, Inc., Las Cruces, New Mexico	2011
Martha I. Dickason	President, DM Dickason Personnel Services, El Paso, Texas	2011
Appointed by the Board of Governors		
D. Kirk Edwards	President, MacLondon Royalty Company, Odessa, Texas	2009
Cindy J. Ramos-Davidson	President and Chief Executive Officer, El Paso Hispanic Chamber of Commerce, El Paso, Texas	2010
Robert E. McKnight, Jr.	Owner, McKnight Ranch Company, Fort Davis, Texas	2011
Houston Branch		
Appointed by the Federal Reserve Bank		
Paul B. Murphy, Jr.	President and Chief Executive Officer, AmegyBank, NA, Houston, Texas	2009
Jodie L. Jiles	Managing Director, RBC Capital Markets, Houston, Texas	2010
Kirk S. Hachigian	Chairman and Chief Executive Officer, Cooper Industries, Ltd., Houston, Texas	2011
Ann B. Stern	Executive Vice President, Texas Children's Hospital, Houston, Texas	2011
Appointed by the Board of Governors		
Jorge A. Bermudez	President and Chief Executive Officer, Byebrook Group, College Station, Texas	2009
Douglas L. Foshee	President and Chief Executive Officer, El Paso Corporation, Houston, Texas	2010
Paul W. Hobby	Chairman and Chief Executive Officer, Alpheus Communications, Houston, Texas	2011
San Antonio Branch		
Appointed by the Federal Reserve Bank		
Thomas E. Dobson	Chairman and Chief Executive Officer, Whataburger Restaurants, LP, San Antonio, Texas	2009
GP Singh	Chief Executive Officer, Gur Parsaad Properties, Ltd., San Antonio, Texas	2010
Ygnacio D. Garza	CPA, Long Chilton LLP, Brownsville, Texas	2011
Guillermo F. Trevino	President, Southern Distributing, Laredo, Texas	2011
Appointed by the Board of Governors		
J. Dan Bates	President, Southwest Research Institute, San Antonio, Texas	2009
Ricardo Romo	President, The University of Texas at San Antonio, San Antonio, Texas	2010
Steven R. Vandegrift	Founder and President, SRV Holdings, Austin, Texas	2011

Bank or Branch, *Category* Name	Title	Term expires Dec. 31
	DISTRICT 12—SAN FRANCISCO	
Reserve Bank		
Class A		
Kenneth P. Wilcox	President and Chief Executive Officer, SVB Financial Group, Santa Clara, California	2009
Arnold T. Grisham	President and Chief Executive Officer, Alta Alliance Bank, Oakland, California	2010
Dann H. Bowman	President and Chief Executive Officer, Chino Commercial Bank, N.A., Chino, California	2011
Class B		
Blake W. Nordstrom	President, Nordstrom, Inc., Seattle, Washington	2009
William D. Jones	President and Chief Executive Officer, CityLink Investment Corporation, San Diego, California	2010
Karla S. Chambers	Vice President and Co-Owner, Stahlbush Island Farms, Inc., Corvallis, Oregon	2011
Class C		
T. Gary Rogers	Retired Chairman of the Board, Levi Strauss and Co., San Francisco, California	2009
Patricia E. Yarrington	Vice President and Chief Financial Officer, Chevron Corporation, San Ramon, California	2010
Douglas W. Shorenstein	Chairman and Chief Executive Officer, Shorenstein Properties LLC, San Francisco, California	2011
Los Angeles Branch		
Appointed by the Federal Reserve Bank		
Eric L. Holoman	President, Magic Johnson Enterprises, Beverly Hills, California	2009
James L. Sanford	Consultant, Northrop Grumman Corporation, Los Angeles, California	2009
Dominic Ng	Chairman and Chief Executive Officer, East West Bank, Pasadena, California	2010
Keith E. Smith	President and Chief Executive Officer, Boyd Gaming Corporation, Las Vegas, Nevada	2011
Appointed by the Board of Governors		
Andrew J. Sale	Partner, Ernst & Young LLP, Los Angeles, California	2009
Grace Evans Cherashore	President and Chief Executive Officer, Evans Hotels, San Diego, California	2010
Ann E. Sewill	President, Community Foundation Land Trust, California Community Foundation, Los Angeles, California	2011
Portland Branch		
Appointed by the Federal Reserve Bank		
Robert D. Sznewajs	President and Chief Executive Officer, West Coast Bancorp, Lake Oswego, Oregon	2009
Roger W. Hinshaw	President, Oregon and SW Washington, Bank of America Oregon, N.A., Portland, Oregon	2010

Directors—continued

BANK OR BRANCH, *Category* Name	Title	Term expires Dec. 31
Peggy Y. Fowler	Retired Chief Executive Officer and President, Portland General Electric, Portland, Oregon	2011
Judith A. Johansen	President, Marylhurst University, Marylhurst, Oregon	2011
Appointed by the Board of Governors		
David Y. Chen	Managing Director, Equilibrium Capital Group LLC, Portland, Oregon	2009
James H. Rudd	Chief Executive Officer and Principal, Ferguson Wellman Capital Management, Inc., Portland, Oregon	2010
Roderick C. Wendt	President and Chief Executive Officer, JELD-WEN, inc., Klamath Falls, Oregon	2011
SALT LAKE CITY BRANCH *Appointed by the Federal Reserve Bank*		
Carol Carter	President and Chief Executive Officer, Industrial Compressor Products, Inc., Park City, Utah	2009
Michael M. Mooney	President, Idaho Region, Bank of the Cascades, Boise, Idaho	2010
Annette Harder	President, Herman Consulting, LLC, Park City, Utah	2011
Robert A. Hatch	Retired President and Chief Executive Officer, Wells Fargo Utah, Salt Lake City, Utah	2011
Appointed by the Board of Governors		
Edwin E. Dahlberg	President and Chief Executive Officer, St. Luke's Health System, Boise, Idaho	2009
Scott L. Hymas	Chief Executive Officer, RC Willey, Salt Lake City, Utah	2010
Clark D. Ivory	Chief Executive Officer, Ivory Homes, Ltd., Salt Lake City, Utah	2011
SEATTLE BRANCH *Appointed by the Federal Reserve Bank*		
Carol K. Nelson	President and Chief Executive Officer, Cascade Financial Corporation, Everett, Washington	2009
Richard Galanti	Executive Vice President and Chief Financial Officer, Costco Wholesale Corporation, Issaquah, Washington	2010
Stan W. McNaughton	Chairman, Chief Executive Officer and President, PEMCO Mutual Insurance, Seattle, Washington	2011
Patrick G. Yalung	Regional President, Washington, Wells Fargo Bank, N.A., Seattle, Washington	2011
Appointed by the Board of Governors		
Helvi K. Sandvik	President, NANA Development Corporation, Anchorage, Alaska	2009
William S. Ayer	Chairman, President, and Chief Executive Officer, Alaska Air Group, Seattle, Washington	2010
Ada M. Healey	Vice President, Real Estate, Vulcan Inc., Seattle, Washington	2011

Members of the Board of Governors, 1913–2009

Appointed Members

Name	Federal Reserve District	Date initially took oath of office	Other dates[1]
Charles S. Hamlin	Boston	Aug. 10, 1914	Reappointed in 1916 and 1926. Served until Feb. 3, 1936.[2]
Paul M. Warburg	New York	Aug. 10, 1914	Term expired Aug. 9, 1918.
Frederic A. Delano	Chicago	Aug. 10, 1914	Resigned July 21, 1918.
W.P.G. Harding	Atlanta	Aug. 10, 1914	Term expired Aug. 9, 1922.
Adolph C. Miller	San Francisco	Aug. 10, 1914	Reappointed in 1924. Reappointed in 1934 from the Richmond District. Served until Feb. 3, 1936.[2]
Albert Strauss	New York	Oct. 26, 1918	Resigned Mar. 15, 1920.
Henry A. Moehlenpah	Chicago	Nov. 10, 1919	Term expired Aug. 9, 1920.
Edmund Platt	New York	June 8, 1920	Reappointed in 1928. Resigned Sept. 14, 1930.
David C. Wills	Cleveland	Sept. 29, 1920	Term expired Mar. 4, 1921.
John R. Mitchell	Minneapolis	May 12, 1921	Resigned May 12, 1923.
Milo D. Campbell	Chicago	Mar. 14, 1923	Died Mar. 22, 1923.
Daniel R. Crissinger	Cleveland	May 1, 1923	Resigned Sept. 15, 1927.
George R. James	St. Louis	May 14, 1923	Reappointed in 1931. Served until Feb. 3, 1936.[3]
Edward H. Cunningham	Chicago	May 14, 1923	Died Nov. 28, 1930.
Roy A. Young	Minneapolis	Oct. 4, 1927	Resigned Aug. 31, 1930.
Eugene Meyer	New York	Sept. 16, 1930	Resigned May 10, 1933.
Wayland W. Magee	Kansas City	May 18, 1931	Term expired Jan. 24, 1933.
Eugene R. Black	Atlanta	May 19, 1933	Resigned Aug. 15, 1934.
M.S. Szymczak	Chicago	June 14, 1933	Reappointed in 1936 and 1948. Resigned May 31, 1961.
J.J. Thomas	Kansas City	June 14, 1933	Served until Feb. 10, 1936.[2]
Marriner S. Eccles	San Francisco	Nov. 15, 1934	Reappointed in 1936, 1940, and 1944. Resigned July 14, 1951.
Joseph A. Broderick	New York	Feb. 3, 1936	Resigned Sept. 30, 1937.
John K. McKee	Cleveland	Feb. 3, 1936	Served until Apr. 4, 1946.[2]
Ronald Ransom	Atlanta	Feb. 3, 1936	Reappointed in 1942. Died Dec. 2, 1947.
Ralph W. Morrison	Dallas	Feb. 10, 1936	Resigned July 9, 1936.
Chester C. Davis	Richmond	June 25, 1936	Reappointed in 1940. Resigned Apr. 15, 1941.
Ernest G. Draper	New York	Mar. 30, 1938	Served until Sept. 1, 1950.[2]
Rudolph M. Evans	Richmond	Mar. 14, 1942	Served until Aug. 13, 1954.[2]
James K. Vardaman, Jr.	St. Louis	Apr. 4, 1946	Resigned Nov. 30, 1958.
Lawrence Clayton	Boston	Feb. 14, 1947	Died Dec. 4, 1949.
Thomas B. McCabe	Philadelphia	Apr. 15, 1948	Resigned Mar. 31, 1951.
Edward L. Norton	Atlanta	Sept. 1, 1950	Resigned Jan. 31, 1952.
Oliver S. Powell	Minneapolis	Sept. 1, 1950	Resigned June 30, 1952.
Wm. McC. Martin, Jr.	New York	Apr. 2, 1951	Reappointed in 1956. Term expired Jan. 31, 1970.
A.L. Mills, Jr.	San Francisco	Feb. 18, 1952	Reappointed in 1958. Resigned Feb. 28, 1965.
J.L. Robertson	Kansas City	Feb. 18, 1952	Reappointed in 1964. Resigned Apr. 30, 1973.
C. Canby Balderston	Philadelphia	Aug. 12, 1954	Served through Feb. 28, 1966.
Paul E. Miller	Minneapolis	Aug. 13, 1954	Died Oct. 21, 1954.
Chas. N. Shepardson	Dallas	Mar. 17, 1955	Retired Apr. 30, 1967.

Appointed Members—continued

Name	Federal Reserve District	Date initially took oath of office	Other dates[1]
G.H. King, Jr.	Atlanta	Mar. 25, 1959	Reappointed in 1960. Resigned Sept. 18, 1963.
George W. Mitchell	Chicago	Aug. 31, 1961	Reappointed in 1962. Served until Feb. 13, 1976.[2]
J. Dewey Daane	Richmond	Nov. 29, 1963	Served until Mar. 8, 1974.[2]
Sherman J. Maisel	San Francisco	Apr. 30, 1965	Served through May 31, 1972.
Andrew F. Brimmer	Philadelphia	Mar. 9, 1966	Resigned Aug. 31, 1974.
William W. Sherrill	Dallas	May 1, 1967	Reappointed in 1968. Resigned Nov. 15, 1971.
Arthur F. Burns	New York	Jan. 31, 1970	Term began Feb. 1, 1970. Resigned Mar. 31, 1978.
John E. Sheehan	St. Louis	Jan. 4, 1972	Resigned June 1, 1975.
Jeffrey M. Bucher	San Francisco	June 5, 1972	Resigned Jan. 2, 1976.
Robert C. Holland	Kansas City	June 11, 1973	Resigned May 15, 1976.
Henry C. Wallich	Boston	Mar. 8, 1974	Resigned Dec. 15, 1986.
Philip E. Coldwell	Dallas	Oct. 29, 1974	Served through Feb. 29, 1980.
Philip C. Jackson, Jr.	Atlanta	July 14, 1975	Resigned Nov. 17, 1978.
J. Charles Partee	Richmond	Jan. 5, 1976	Served until Feb. 7, 1986.[2]
Stephen S. Gardner	Philadelphia	Feb. 13, 1976	Died Nov. 19, 1978.
David M. Lilly	Minneapolis	June 1, 1976	Resigned Feb. 24, 1978.
G. William Miller	San Francisco	Mar. 8, 1978	Resigned Aug. 6, 1979.
Nancy H. Teeters	Chicago	Sept. 18, 1978	Served through June 27, 1984.
Emmett J. Rice	New York	June 20, 1979	Resigned Dec. 31, 1986.
Frederick H. Schultz	Atlanta	July 27, 1979	Served through Feb. 11, 1982.
Paul A. Volcker	Philadelphia	Aug. 6, 1979	Resigned Aug. 11, 1987.
Lyle E. Gramley	Kansas City	May 28, 1980	Resigned Sept. 1, 1985.
Preston Martin	San Francisco	Mar. 31, 1982	Resigned Apr. 30, 1986.
Martha R. Seger	Chicago	July 2, 1984	Resigned Mar. 11, 1991.
Wayne D. Angell	Kansas City	Feb. 7, 1986	Served through Feb. 9, 1994.
Manuel H. Johnson	Richmond	Feb. 7, 1986	Resigned Aug. 3, 1990.
H. Robert Heller	San Francisco	Aug. 19, 1986	Resigned July 31, 1989.
Edward W. Kelley, Jr.	Dallas	May 26, 1987	Resigned Dec. 31, 2001.
Alan Greenspan	New York	Aug. 11, 1987	Resigned Jan. 31, 2006.
John P. LaWare	Boston	Aug. 15, 1988	Resigned Apr. 30, 1995.
David W. Mullins, Jr.	St. Louis	May 21, 1990	Resigned Feb. 14, 1994.
Lawrence B. Lindsey	Richmond	Nov. 26, 1991	Resigned Feb. 5, 1997.
Susan M. Phillips	Chicago	Dec. 2, 1991	Served through June 30, 1998.
Alan S. Blinder	Philadelphia	June 27, 1994	Term expired Jan. 31, 1996.
Janet L. Yellen	San Francisco	Aug. 12, 1994	Resigned Feb. 17, 1997.
Laurence H. Meyer	St. Louis	June 24, 1996	Term expired Jan. 31, 2002.
Alice M. Rivlin	Philadelphia	June 25, 1996	Resigned July 16, 1999.
Roger W. Ferguson, Jr.	Boston	Nov. 5, 1997	Resigned Apr. 28, 2006.
Edward M. Gramlich	Richmond	Nov. 5, 1997	Resigned Aug. 31, 2005.
Susan S. Bies	Chicago	Dec. 7, 2001	Resigned Mar. 30, 2007.
Mark W. Olson	Minneapolis	Dec. 7, 2001	Resigned June 20, 2006.
Ben S. Bernanke	Atlanta	Aug. 5, 2002	Resigned June 21, 2005.
Donald L. Kohn	Kansas City	Aug. 5, 2002	
Ben. S. Bernanke	Atlanta	Feb. 1, 2006	
Kevin M. Warsh	New York	Feb. 24, 2006	
Randall S. Kroszner	Richmond	Mar. 1, 2006	Served through Jan. 21, 2009.
Frederic S. Mishkin	Boston	Sept. 5, 2006	Resigned Aug. 31, 2008.
Elizabeth A. Duke	Philadelphia	Aug. 5, 2008	
Daniel K. Tarullo	Boston	Jan. 28, 2009	

Appointed Members—continued

Name	Term
Chairmen [3]	
Charles S. Hamlin	Aug. 10, 1914–Aug. 9, 1916
W.P.G. Harding	Aug. 10, 1916–Aug. 9, 1922
Daniel R. Crissinger	May 1, 1923–Sept. 15, 1927
Roy A. Young	Oct. 4, 1927–Aug. 31, 1930
Eugene Meyer	Sept. 16, 1930–May 10, 1933
Eugene R. Black	May 19, 1933–Aug. 15, 1934
Marriner S. Eccles	Nov. 15, 1934–Jan. 31, 1948 [4]
Thomas B. McCabe	Apr. 15, 1948–Mar. 31, 1951
Wm. McC. Martin, Jr.	Apr. 2, 1951–Jan. 31, 1970
Arthur F. Burns	Feb. 1, 1970–Jan. 31, 1978
G. William Miller	Mar. 8, 1978–Aug. 6, 1979
Paul A. Volcker	Aug. 6, 1979–Aug. 11, 1987
Alan Greenspan	Aug. 11, 1987–Jan. 31, 2006 [5]
Ben Bernanke	Feb. 1, 2006–
Vice Chairmen [3]	
Frederic A. Delano	Aug. 10, 1914–Aug. 9, 1916
Paul M. Warburg	Aug. 10, 1916–Aug. 9, 1918
Albert Strauss	Oct. 26, 1918–Mar. 15, 1920
Edmund Platt	July 23, 1920–Sept. 14, 1930
J.J. Thomas	Aug. 21, 1934–Feb. 10, 1936
Ronald Ransom	Aug. 6, 1936–Dec. 2, 1947
C. Canby Balderston	Mar. 11, 1955–Feb. 28, 1966
J.L. Robertson	Mar. 1, 1966–Apr. 30, 1973
George W. Mitchell	May 1, 1973–Feb. 13, 1976
Stephen S. Gardner	Feb. 13, 1976–Nov. 19, 1978
Frederick H. Schultz	July 27, 1979–Feb. 11, 1982
Preston Martin	Mar. 31, 1982–Apr. 30, 1986
Manuel H. Johnson	Aug. 4, 1986–Aug. 3, 1990
David W. Mullins, Jr.	July 24, 1991–Feb. 14, 1994
Alan S. Blinder	June 27, 1994–Jan. 31, 1996
Alice M. Rivlin	June 25, 1996–July 16, 1999
Roger W. Ferguson, Jr.	Oct. 5, 1999–Apr. 28, 2006
Donald L. Kohn	June 23, 2006–

NOTE: Under the original Federal Reserve Act, the Federal Reserve Board was composed of five appointed members, the Secretary of the Treasury (ex officio chairman of the Board), and the Comptroller of the Currency. The original term of office was ten years; the five original appointed members had terms of two, four, six, eight, and ten years. In 1922 the number of appointed members was increased to six, and in 1933 the term of office was raised to twelve years. The Banking Act of 1935 changed the name to the Board of Governors of the Federal Reserve System and provided that the Board be composed of seven appointed members; that the Secretary of the Treasury and the Comptroller of the Currency continue to serve until Feb. 1, 1936; that the appointed members in office on Aug. 23, 1935, continue to serve until Feb. 1, 1936, or until their successors were appointed and had qualified; and that thereafter the terms of members be fourteen years and that the designation of Chairman and Vice Chairman of the Board be for four years.

1. Date following "Resigned" and "Retired" denotes final day of service.
2. Successor took office on this date.
3. Before Aug. 23, 1935, Chairmen and Vice Chairmen were designated Governor and Vice Governor.
4. Served as Chairman Pro Tempore from Feb. 3, 1948, to Apr. 15, 1948.
5. Served as Chairman Pro Tempore from Mar. 3, 1996, to June 20, 1996.

Ex Officio Members

Name	Term
Secretaries of the Treasury	
W.G. McAdoo	Dec. 23, 1913–Dec. 15, 1918
Carter Glass	Dec. 16, 1918–Feb. 1, 1920
David F. Houston	Feb. 2, 1920–Mar. 3, 1921
Andrew W. Mellon	Mar. 4, 1921–Feb. 12, 1932
Ogden L. Mills	Feb. 12, 1932–Mar. 4, 1933
William H. Woodin	Mar. 4, 1933–Dec. 31, 1933
Henry Morgenthau, Jr.	Jan. 1, 1934–Feb. 1, 1936
Comptrollers of the Currency	
John Skelton Williams	Feb. 2, 1914–Mar. 2, 1921
Daniel R. Crissinger	Mar. 17, 1921–Apr. 30, 1923
Henry M. Dawes	May 1, 1923–Dec. 17, 1924
Joseph W. McIntosh	Dec. 20, 1924–Nov. 20, 1928
J.W. Pole	Nov. 21, 1928–Sept. 20, 1932
J.F.T. O'Connor	May 11, 1933–Feb. 1, 1936

Statistical Tables

1. Federal Reserve Open Market Transactions, 2009

Millions of dollars

Type of security and transaction	Jan.	Feb.	Mar.	Apr.
U.S. Treasury Securities[1]				
Outright transactions[2]				
Treasury bills				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Exchanges	24,708	18,423	23,458	18,423
For new bills	24,708	18,423	23,458	18,423
Redemptions	0	0	0	0
Others within 1 year				
Gross purchases	0	0	0	0
Gross sales	0	0	0	0
Maturity shifts	0	0	0	0
Exchanges	0	0	0	0
Redemptions	0	0	0	0
1 to 5 years				
Gross purchases	0	0	7,541	43,740
Gross sales	0	0	0	0
Maturity shifts	0	0	0	0
Exchanges	0	0	0	0
5 to 10 years				
Gross purchases	0	0	7,500	8,996
Gross sales	0	0	0	0
Maturity shifts	0	0	0	0
Exchanges	0	0	0	0
More than 10 years				
Gross purchases	0	0	2,499	3,466
Gross sales	0	0	0	0
Maturity shifts	0	0	0	0
Discount notes	0	0	0	0
All maturities				
Gross purchases	0	0	17,540	56,202
Gross sales	0	0	0	0
Redemptions	0	0	0	0
Net change in U.S. Treasury securities	0	0	17,540	56,202

For notes, refer to end of table.

1.—*continued*

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
16,005	18,423	24,361	18,423	16,005	18,423	12,138	24,708	233,498
16,005	18,423	24,361	18,423	16,005	18,423	12,138	24,708	233,498
0	0	0	0	0	0	0	0	0
1,380	0	829	0	40	0	0	0	2,249
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
28,185	15,044	21,532	25,784	14,404	1,936	0	0	158,166
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
17,407	28,397	17,088	8,170	5,500	2,949	0	0	96,007
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
9,820	6,749	9,043	7,602	2,049	2,350	0	0	43,578
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
56,792	50,190	48,492	41,556	21,993	7,235	0	0	300,000
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	0
56,792	50,190	48,492	41,556	21,993	7,235	0	0	300,000

1. Federal Reserve Open Market Transactions, 2009—*continued*

Millions of dollars

Type of security and transaction	Jan.	Feb.	Mar.	Apr.
FEDERAL AGENCY OBLIGATIONS				
Outright transactions [2]				
Gross purchases	9,600	9,413	13,703	17,765
Gross sales	0	0	0	0
Redemptions	0	0	0	0
Net change in federal agency obligations	9,600	9,413	13,703	17,765
MORTGAGE-BACKED SECURITIES[3]				
Net Settlements[2]				
Net change in mortgage-backed securities	7,377	61,470	167,789	129,331
TEMPORARY TRANSACTIONS				
Repurchase agreements[4]				
Gross purchases	0	0	0	0
Gross sales	80,000	0	0	0
Reverse repurchase agreements[5]				
Gross purchases	1,593,534	1,365,436	1,485,898	1,483,810
Gross sales	1,581,950	1,362,861	1,482,294	1,481,260
Net change in temporary transactions	–68,417	2,575	3,605	2,550
Total net change in System Open Market Account	**–51,440**	**73,458**	**202,637**	**205,848**

NOTE: Sales, redemptions, and negative figures reduce holdings of the System Open Market Account; all other figures increase such holdings. Components may not sum to totals because of rounding.

1. Transactions exclude changes in compensation for the effects of inflation on the principal of inflation-indexed securities. Transactions include the rollover of inflation compensation into new securities.

2. Excludes the effect of temporary transactions—repurchase agreements and reverse repurchase agreements.

3. Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae. Monthly net change in face value of the securities held, which is the remaining principal balance of the underlying mortgages.

4. Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities.

5. Cash value of agreements, which are collateralized by U.S. Treasury securities and federal agency debt securities.

1.—*continued*

May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	Total
11,595	16,873	9,485	13,423	12,589	15,783	8,108	3,141	141,478
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	30	30
11,595	16,873	9,485	13,423	12,589	15,783	8,108	3,111	141,448
61,639	34,819	80,464	82,027	67,448	81,972	77,819	56,216	908,371
0	0	0	0	0	0	0	0	0
0	0	0	0	0	0	0	0	80,000
1,366,185	1,514,269	1,575,058	1,436,812	1,437,572	1,356,242	1,206,922	1,317,821	17,139,559
1,364,285	1,520,799	1,570,459	1,439,045	1,436,182	1,355,268	1,197,005	1,338,611	17,130,019
1,901	–6,530	4,599	–2,233	1,390	974	9,917	–20,790	–70,459
131,927	**95,352**	**143,040**	**134,773**	**103,420**	**105,964**	**95,844**	**38,537**	**1,279,360**

2. Federal Reserve Bank Holdings of U.S. Treasury and Federal Agency Securities, December 31, 2007–2009

Millions of dollars

Description	December 31			Change	
	2009	2008	2007	2008 to 2009	2007 to 2008
U.S. Treasury Securities					
Held outright[1]	**776,588**	**475,921**	**740,611**	**300,667**	**–264,690**
By remaining maturity					
Bills					
1–90 days	18,423	18,423	153,829	0	–135,406
91 days to 1 year	0	0	74,012	0	–74,012
Notes and bonds					
1 year or less	72,818	85,011	101,447	–12,193	–16,436
More than 1 year through 5 years	326,874	173,328	240,562	153,546	–67,234
More than 5 years through 10 years	213,720	97,325	81,947	116,395	15,378
More than 10 years	144,753	101,834	88,814	42,919	13,020
By type					
Bills	18,423	18,423	227,841	0	–209,418
Notes	568,323	334,779	401,776	233,544	–66,997
Bonds	189,843	122,719	110,995	67,124	11,724
Federal Agency Securities					
Held outright[1]	**159,879**	**19,708**	**0**	**140,171**	**19,708**
By remaining maturity					
Discount notes					
1–90 days	0	3,731	0	–3,731	3,731
91 days to 1 year	0	946	0	–946	946
Coupons					
1 year or less	24,642	30	0	24,612	30
More than 1 year through 5 years	99,402	11,361	0	88,041	11,361
More than 5 years though 10 years	33,788	3,640	0	30,148	3,640
More than 10 years	2,047	0	0	2,047	0
By type					
Discount notes	0	4,677	0	–4,677	4,677
Coupons	159,879	15,031	0	144,848	15,031
By issuer					
Federal Home Loan Mortgage Corporation	61,769	9,556	0	52,213	9,556
Federal National Mortgage Association	63,662	7,091	0	56,571	7,091
Federal Home Loan Banks	34,448	3,061	0	31,387	3,061
Mortgage-Backed Securities[2]					
Held outright[1]	**908,371**	**0**	**0**	**908,371**	**0**
By remaining maturity					
1 year or less	0	0	0	0	0
More than 1 year through 5 years	12	0	0	12	0
More than 5 years though 10 years	20	0	0	20	0
More than 10 years	908,340	0	0	908,340	0
By issuer					
Federal Home Loan Mortgage Corporation	304,964	0	0	304,964	0
Federal National Mortgage Association	513,398	0	0	513,398	0
Government National Mortgage Association	90,010	0	0	90,010	0
Temporary Transactions					
Repurchase agreements[3]	**0**	**80,000**	**46,500**	**–80,000**	**33,500**
Reverse repurchase agreements[4]	**77,732**	**88,352**	**43,985**	**–10,620**	**44,367**
Foreign official and international accounts	77,732	88,352	43,985	–10,620	44,367
Dealers	0	0	0	0	0

Note: Components may not sum to totals because of rounding.

1. Excludes the effect of temporary transactions—repurchase agreements and reverse repurchase agreements.
2. Guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae.
3. Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities.
4. Cash value of agreements, which are collateralized by U.S. Treasury securities and federal agency debt securities.

3. Federal Reserve Bank Interest Rates on Loans to Depository Institutions

Percent

A. Rates on Selected Loans as of December 31, 2009[1]

Reserve Bank	Primary credit	Secondary credit	Seasonal credit
All Banks	0.50	1.00	0.15

1. For details on rate changes over the course of 2009, see the section on discount rates in the chapter "Record of Policy Actions of the Board of Governors." In ordinary circumstances, *primary credit* is available for very short terms as a backup source of liquidity to depository institutions that are in generally sound financial condition in the judgment of the lending Federal Reserve Bank. On March 16, 2008, the Board announced a temporary change to the Reserve Banks' discount window lending practices to allow the provision of term financing for as long as 90 days. On November 17, 2009, the Board announced a reduction in the maximum maturity of such financing to 28 days effective January 14, 2010. *Secondary credit* is available in appropriate circumstances to depository institutions that do not qualify for primary credit. *Seasonal credit* is available to help relatively small depository institutions meet regular seasonal needs for funds that arise from a clear pattern of intra-yearly movements in their deposits and loans.

B. Rates on Term Auction Facility Loans Outstanding on December 31, 2009[2]

Reserve Bank	Auction date	Rate
All Banks	Nov. 2, 2009	0.250
	Nov. 30, 2009	0.250
	Dec. 14, 2009	0.250

2. Under the Term Auction Facility (TAF), the Federal Reserve auctions term funds to depository institutions that are in generally sound financial condition and are eligible to borrow under the primary credit program. Loans from three auctions were outstanding on December 31, 2009.

4. Reserve Requirements of Depository Institutions, December 31, 2009

Type of deposit	Requirements	
	Percentage of deposits	Effective date
Net transaction accounts[1]		
$0 million–$10.7 million[2]	0	12-31-09
More than $10.7 million–$55.2 million[3]	3	12-31-09
More than $55.2 million	10	12-31-09
Nonpersonal time deposits	0	12-27-90
Eurocurrency liabilities	0	12-27-90

NOTE: Required reserves must be held in the form of vault cash and, if vault cash is insufficient, also in the form of a deposit with a Federal Reserve Bank. An institution that is a member of the Federal Reserve System must hold that deposit directly with a Reserve Bank; an institution that is not a member of the System can maintain that deposit directly with a Reserve Bank or with another institution in a pass-through relationship. Reserve requirements are imposed on commercial banks, savings banks, savings and loan associations, credit unions, U.S. branches and agencies of foreign banks, Edge corporations, and agreement corporations.

1. Total transaction accounts consist of demand deposits, automatic transfer service (ATS) accounts, NOW accounts, share draft accounts, telephone or preauthorized transfer accounts, ineligible acceptances, and affiliate-issued obligations maturing in seven days or less. Net transaction accounts are total transaction accounts less amounts due from other depository institutions and less cash items in the process of collection.

For a more detailed description of these deposit types, see Form FR 2900.

2. The amount of net transaction accounts subject to a reserve requirement ratio of 0 percent (the “exemption amount”) is adjusted each year by statute. The exemption amount is adjusted upward by 80 percent of the previous year’s (June 30 to June 30) rate of increase in total reservable liabilities at all depository institutions. No adjustment is made in the event of a decrease in such liabilities.

3. The amount of net transaction accounts subject to a reserve requirement ratio of 3 percent is the “low reserve tranche.” By statute, the upper limit of the low reserve tranche is adjusted each year by 80 percent of the previous year’s (June 30 to June 30) rate of increase or decrease in net transaction accounts held by all depository institutions.

5. Banking Offices and Banks Affiliated with Bank Holding Companies in the United States, December 31, 2008 and 2009

Type of office	Total	Commercial banks[1]					State-chartered savings banks
		Total	Member			Non-member	
			Total	National	State		
	All banking offices						
BANKS							
Number, Dec. 31, 2008	**7,403**	**7,050**	**2,379**	**1,522**	**857**	**4,671**	**353**
Changes during 2009							
New banks	34	33	12	10	2	21	1
Banks converted into branches	–149	–145	–52	–37	–15	–93	–4
Ceased banking operations[2]	–131	–131	–47	–28	–19	–84	0
Other[3]	0	1	–4	–19	15	5	–1
Net change	–246	–242	–91	–74	–17	–151	–4
Number, Dec. 31, 2009	**7,157**	**6,808**	**2,288**	**1,448**	**840**	**4,520**	**349**
BRANCHES AND ADDITIONAL OFFICES							
Number, Dec. 31, 2008	**83,826**	**80,744**	**57,083**	**42,988**	**14,095**	**23,661**	**3,082**
Changes during 2009							
New branches	1,998	1,943	1,454	1,047	407	489	55
Branches converted from banks	149	145	66	34	32	79	4
Discontinued[2]	–1,613	–1,565	–1,160	–868	–292	–405	–48
Other[3]	0	9	220	–43	263	–211	–9
Net change	534	532	580	170	410	–48	2
Number, Dec. 31, 2009	**84,360**	**81,276**	**57,663**	**43,158**	**14,505**	**23,613**	**3,084**
	Banks affiliated with bank holding companies						
BANKS							
Number, Dec. 31, 2008	**5,973**	**5,847**	**2,096**	**1,343**	**753**	**3,751**	**126**
Changes during 2009							
BHC-affiliated new banks	73	66	16	10	6	50	7
Banks converted into branches	–133	–131	–50	–36	–14	–81	–2
Ceased banking operations[2]	–128	–127	–47	–28	–19	–80	–1
Other[3]	0	1	–5	–19	14	6	–1
Net change	–188	–191	–86	–73	–13	–105	3
Number, Dec. 31, 2009	**5,785**	**5,656**	**2,010**	**1,270**	**740**	**3,646**	**129**

NOTE: Includes banks, banking offices, and bank holding companies in U.S. territories and possessions (affiliated insular areas).

1. For purposes of this table, banks are entities that are defined as banks in the Bank Holding Company Act, as amended, which is implemented by Federal Reserve Regulation Y. Generally, a bank is any institution that accepts demand deposits and is engaged in the business of making commercial loans or any institution that is defined as an insured bank in section 3(h) of the FDIC Act.

2. Institutions that no longer meet the Regulation Y definition of a bank.

3. Interclass changes and sales of branches.

6A. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items, Year-End 1984–2009 and Month-End 2009

Millions of dollars

Period	Factors supplying reserve funds								
	Federal Reserve Bank credit outstanding						Gold stock	Special drawing rights certificate account	Treasury currency outstanding [4]
	Securities held outright [1]	Repurchase agreements [2]	Loans and other credit extensions [3]	Float	Other Federal Reserve assets	Total			
1984	167,612	2,015	3,577	833	12,347	186,384	11,096	4,618	16,418
1985	186,025	5,223	3,060	988	15,302	210,598	11,090	4,718	17,075
1986	205,454	16,005	1,565	1,261	17,475	241,760	11,084	5,018	17,567
1987	226,459	4,961	3,815	811	15,837	251,883	11,078	5,018	18,177
1988	240,628	6,861	2,170	1,286	18,803	269,748	11,060	5,018	18,799
1989	233,300	2,117	481	1,093	39,631	276,622	11,059	8,518	19,628
1990	241,431	18,354	190	2,222	39,897	302,091	11,058	10,018	20,402
1991	272,531	15,898	218	731	34,567	323,945	11,059	10,018	21,014
1992	300,423	8,094	675	3,253	30,020	342,464	11,056	8,018	21,447
1993	336,654	13,212	94	909	33,035	383,904	11,053	8,018	22,095
1994	368,156	10,590	223	–716	33,634	411,887	11,051	8,018	22,994
1995	380,831	13,862	135	107	33,303	428,239	11,050	10,168	24,003
1996	393,132	21,583	85	4,296	32,896	451,992	11,048	9,718	24,966
1997	431,420	23,840	2,035	719	31,452	489,466	11,047	9,200	25,543
1998	452,478	30,376	17	1,636	36,966	521,475	11,046	9,200	26,270
1999	478,144	140,640	233	–237	35,321	654,100	11,048	6,200	28,013
2000	511,833	43,375	110	901	36,467	592,686	11,046	2,200	31,643
2001	551,685	50,250	34	–23	37,658	639,604	11,045	2,200	33,017
2002	629,416	39,500	40	418	39,083	708,457	11,043	2,200	34,597
2003	666,665	43,750	62	–319	40,848	751,006	11,043	2,200	35,468
2004	717,819	33,000	43	925	42,219	794,007	11,045	2,200	36,434
2005	744,215	46,750	72	885	39,611	831,532	11,043	2,200	36,540
2006	778,915	40,750	67	–333	39,895	859,294	11,041	2,200	38,206
2007	740,611	46,500	72,636	–19	41,945	901,674	11,041	2,200	38,681
2008	495,629	80,000	1,605,848	–1,494	43,568	2,223,552	11,041	2,200	38,674
2009	1,844,838	0	281,095	–2,097	92,444	2,216,280	11,041	5,200	42,698

For notes, refer to end of table.

6A.—*continued*

Factors absorbing reserve funds									Reserve balances with Federal Reserve Banks
Currency in circulation	Reverse repurchase agreements [5]	Treasury cash holdings [6]	Deposits with Federal Reserve Banks, other than reserve balances				Required clearing balances	Other Federal Reserve liabilities and capital	
			Treasury general account	Treasury supplementary financing account	Foreign	Other			
183,796	0	513	5,316	. . .	253	867	1,126	5,952	20,693
197,488	0	550	9,351	. . .	480	1,041	1,490	5,940	27,141
211,995	0	447	7,588	. . .	287	917	1,812	6,088	46,295
230,205	0	454	5,313	. . .	244	1,027	1,687	7,129	40,097
247,649	0	395	8,656	. . .	347	548	1,605	7,683	37,742
260,456	0	450	6,217	. . .	589	1,298	1,618	8,486	36,713
286,963	0	561	8,960	. . .	369	528	1,960	8,147	36,081
307,756	0	636	17,697	. . .	968	1,869	3,946	8,113	25,051
334,701	0	508	7,492	. . .	206	653	5,897	7,984	25,544
365,271	0	377	14,809	. . .	386	636	6,332	9,292	27,967
403,843	0	335	7,161	. . .	250	1,143	4,196	11,959	25,061
424,244	0	270	5,979	. . .	386	2,113	5,167	12,342	22,960
450,648	0	249	7,742	. . .	167	1,178	6,601	13,829	17,310
482,327	0	225	5,444	. . .	457	1,171	6,684	15,500	23,447
517,484	0	85	6,086	. . .	167	1,869	6,780	16,354	19,164
628,359	0	109	28,402	. . .	71	1,644	7,481	17,256	16,039
593,694	0	450	5,149	. . .	216	2,478	6,332	17,962	11,295
643,301	0	425	6,645	. . .	61	1,356	8,525	17,083	8,469
687,518	21,091	367	4,420	. . .	136	1,266	10,534	18,977	11,988
724,187	25,652	321	5,723	. . .	162	995	11,829	19,793	11,055
754,877	30,783	270	5,912	. . .	80	1,285	9,963	26,378	14,137
794,014	30,505	202	4,573	. . .	83	2,144	8,651	30,466	10,678
820,176	29,615	252	4,708	. . .	98	972	6,842	36,231	11,847
828,938	43,985	259	16,120	. . .	96	1,830	6,614	41,622	14,132
889,898	88,352	259	106,123	259,325	1,365	21,221	4,387	48,921	855,614
928,256	77,732	239	186,632	5,001	2,411	35,262	3,021	63,219	973,446

6A. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items, Year-End 1984–2009 and Month-End 2009—*continued*

Millions of dollars

Period	Factors supplying reserve funds								
	Federal Reserve Bank credit outstanding						Gold stock	Special drawing rights certificate account	Treasury currency outstanding [4]
	Securities held outright [1]	Repurchase agreements [2]	Loans and other credit extensions [3]	Float	Other Federal Reserve assets	Total			
2009									
Jan	510,788	0	1,292,050	–1,549	44,366	1,845,656	11,041	2,200	42,110
Feb	581,679	0	1,270,642	–2,258	43,590	1,893,654	11,041	2,200	42,178
Mar	779,352	0	1,242,713	–3,075	45,326	2,064,316	11,041	2,200	42,261
Apr	983,179	0	988,424	–2,095	59,728	2,029,236	11,041	2,200	42,319
May	1,113,515	0	884,837	–1,450	69,496	2,066,398	11,041	2,200	42,333
Jun	1,215,517	0	693,889	–2,831	73,139	1,979,714	11,041	2,200	42,427
Jul	1,354,066	0	546,618	–1,535	79,635	1,978,785	11,041	2,200	42,481
Aug	1,491,500	0	494,401	–1,440	79,565	2,064,026	11,041	2,200	42,487
Sep	1,592,701	0	448,072	–2,535	85,087	2,123,325	11,041	5,200	42,564
Oct	1,697,804	0	363,321	–1,647	90,348	2,149,825	11,041	5,200	42,607
Nov	1,783,761	0	314,311	–1,103	90,250	2,187,221	11,041	5,200	42,663
Dec	1,844,838	0	281,095	–2,097	92,444	2,216,280	11,041	5,200	42,698

6A.—*continued*

Factors absorbing reserve funds										Reserve balances with Federal Reserve Banks
Currency in circulation	Reverse repurchase agreements [5]	Treasury cash holdings [6]	Deposits with Federal Reserve Banks, other than reserve balances				Required clearing balances	Other Federal Reserve liabilities and capital		
			Treasury general account	Treasury supplementary financing account	Foreign	Other				
887,575	76,769	297	23,548	169,962	134	1,529	4,429	48,905		687,860
897,504	74,194	282	23,502	199,950	1,370	15,193	4,466	51,263		681,350
903,715	70,590	311	67,151	199,934	1,139	21,019	4,428	55,628		795,905
903,300	68,040	311	136,194	199,929	1,782	338	4,343	56,287		714,272
908,505	66,139	301	15,222	199,933	1,932	317	4,224	51,930		873,468
909,725	72,669	318	115,985	199,939	1,749	20,123	4,190	54,362		656,323
909,709	68,070	302	92,971	199,935	3,094	387	5,119	56,903		698,017
910,289	70,303	255	93,333	199,932	2,386	315	4,077	59,600		779,263
913,791	68,913	293	108,324	164,945	1,913	15,902	3,402	59,804		844,842
913,752	67,939	257	19,721	14,999	3,008	10,782	3,233	64,677		1,110,305
923,009	58,021	233	99,236	14,999	2,717	371	3,033	65,853		1,078,653
928,256	77,732	239	186,632	5,001	2,411	35,262	3,021	63,219		973,446

NOTE: Components may not sum to totals because of rounding.

1. Includes U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities. U.S. Treasury securities and federal agency debt securities include securities lent to dealers, which are fully collateralized by U.S. Treasury securities, federal agency securities, and other highly rated debt securities.

2. Cash value of agreements, which are collateralized by U.S. Treasury securities, federal agency debt securities, and mortgage-backed securities.

3. Refer to table 6B for detail.

4. Includes currency and coin (other than gold) issued directly by the U.S. Treasury. The largest components are fractional and dollar coins. For details refer to “U.S. Currency and Coin Outstanding and in Circulation,” *Treasury Bulletin.*

5. Cash value of agreements, which are collateralized by U.S. Treasury securities and federal agency debt securities.

6. Coin and paper currency held by the Treasury, as well as gold in excess of the gold certificates issued to the Federal Reserve Banks.

. . . Not applicable.

6B. Loans and Other Credit Extensions, by Type, Year-End 1984–2009 and Month-End 2009

Millions of dollars

Period	Total	Primary, secondary, and seasonal credit[1]	Primary Dealer Credit Facility[2]	Term auction credit	Central bank liquidity swaps[3]	AMLF[4]	TALF[5]
1984	3,577	3,577	...	...	...	...	...
1985	3,060	3,060	...	...	...	...	...
1986	1,565	1,565	...	...	...	...	...
1987	3,815	3,815	...	...	...	...	...
1988	2,170	2,170	...	...	...	...	...
1989	481	481	...	...	...	...	...
1990	190	190	...	...	...	...	...
1991	218	218	...	...	...	...	...
1992	675	675	...	...	...	...	...
1993	94	94	...	...	...	...	...
1994	223	223	...	...	...	...	...
1995	135	135	...	...	...	...	...
1996	85	85	...	...	...	...	...
1997	2,035	2,035	...	...	...	...	...
1998	17	17	...	...	...	...	...
1999	233	233	...	...	...	...	...
2000	110	110	...	...	...	...	...
2001	34	34	...	...	...	...	...
2002	40	40	...	...	...	...	...
2003	62	62	...	...	...	...	...
2004	43	43	...	...	...	...	...
2005	72	72	...	...	...	...	...
2006	67	67	...	...	...	...	...
2007	72,636	8,636	...	40,000	24,000	...	...
2008	1,605,848	93,791	37,404	450,219	553,728	23,765	...
2009	281,095	20,700	0	75,918	10,272	0	47,532

For notes, refer to end of table.

6B.—*continued*

Millions of dollars

CPFF[6]	MMIFF[7]	AIG[8]	Preferred interests in AIA/ALICO LLCs[9]	Maiden Lane LLC[10]	Maiden Lane II LLC[10]	Maiden Lane III LLC[10]	TALF LLC[11]
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
334,102	0	38,914	. . .	27,023	20,117	26,785	. . .
14,064	. . .	22,184	25,106	26,701	15,659	22,661	298

6B. Loans and Other Credit Extensions, by Type, Year-End 1984–2009 and Month-End 2009—*continued*

Millions of dollars

Period	Total	Primary, secondary, and seasonal credit[1]	Primary Dealer Credit Facility[2]	Term auction credit	Central bank liquidity swaps[3]	AMLF[4]	TALF[5]
2009							
Jan	1,292,050	67,485	31,553	412,883	387,448	17,131	. . .
Feb	1,270,642	65,438	23,564	493,145	321,214	10,100	. . .
Mar	1,242,713	69,080	18,116	467,278	309,917	6,745	4,692
Apr	988,424	43,361	700	403,573	249,302	3,798	6,379
May	884,837	41,906	0	372,540	177,652	25,696	15,451
Jun	693,889	35,863	0	282,808	114,585	14,911	25,112
Jul	546,618	35,663	0	233,673	76,271	756	30,344
Aug	494,401	33,393	0	212,110	63,287	79	37,272
Sep	448,072	28,800	0	178,379	56,756	79	42,709
Oct	363,321	23,047	0	139,245	31,884	0	43,165
Nov	314,311	19,978	0	101,009	23,038	0	44,469
Dec	281,095	20,700	0	75,918	10,272	0	47,532

6B.—*continued*

Millions of dollars

CPFF[6]	MMIFF[7]	AIG[8]	Preferred interests in AIA/ALICO LLCs[9]	Maiden Lane LLC[10]	Maiden Lane II LLC[10]	Maiden Lane III LLC[10]	TALF LLC[11]
264,316	0	39,041	. . .	25,772	18,964	27,456	. . .
243,204	0	41,665	. . .	25,969	18,647	27,695	. . .
248,537	0	45,966	. . .	26,288	18,449	27,645	. . .
163,539	0	45,493	. . .	26,502	18,328	27,449	. . .
145,453	0	43,720	. . .	25,771	16,262	20,388	. . .
115,002	0	43,457	. . .	25,921	16,060	20,170	. . .
66,122	0	41,607	. . .	25,895	15,145	21,142	. . .
47,682	0	38,681	. . .	26,053	14,946	20,897	. . .
41,029	0	38,743	. . .	26,261	14,751	20,566	. . .
15,899	0	44,617	. . .	26,284	16,008	23,172	. . .
15,028	. . .	45,285	. . .	26,425	15,846	22,968	266
14,064	. . .	22,184	25,106	26,701	15,659	22,661	298

NOTE: Components may not sum to totals because of rounding.

1. Prior to 2003, category was “Adjustment, extended, and seasonal credit.”

2. Includes credit extended through the Primary Dealer Credit Facility and credit extended to certain other broker-dealers.

3. Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

4. Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility.

5. Includes credit extended by the Federal Reserve Bank of New York (FRBNY) to eligible borrowers through the Term Asset-Backed Securities Loan Facility (TALF), net of unamortized deferred administrative fees.

6. Net portfolio holdings of Commercial Paper Funding Facility LLC.

7. Net portfolio holdings of Money Market Investor Funding Facility LLC. The MMIFF was discontinued in November 2009.

8. Credit extended to American International Group, Inc., includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring. Excludes credit extended to consolidated LLCs.

9. Preferred interests in AIA Aurora LLC and ALICO Holdings LLC at book value.

10. Net portfolio holdings at fair value.

11. Net portfolio holdings of TALF LLC, a limited liability company formed to purchase and manage any asset-backed securities that might be surrendered by a TALF borrower or otherwise claimed by the FRBNY in connection with its enforcement rights to the TALF collateral.

. . . Not applicable.

6C. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items, Year-End 1918–1983

Millions of dollars

Period	Factors supplying reserve funds									
	Federal Reserve Bank credit outstanding							Gold stock [6]	Special drawing rights certificate account	Treasury currency out-standing [7]
	Securities held outright [1]	Repur-chase agree-ments [2]	Loans	Float [3]	All other [4]	Other Federal Reserve assets [5]	Total			
1918	239	0	1,766	199	294	0	2,498	2,873	. . .	1,795
1919	300	0	2,215	201	575	0	3,292	2,707	. . .	1,707
1920	287	0	2,687	119	262	0	3,355	2,639	. . .	1,709
1921	234	0	1,144	40	146	0	1,563	3,373	. . .	1,842
1922	436	0	618	78	273	0	1,405	3,642	. . .	1,958
1923	80	54	723	27	355	0	1,238	3,957	. . .	2,009
1924	536	4	320	52	390	0	1,302	4,212	. . .	2,025
1925	367	8	643	63	378	0	1,459	4,112	. . .	1,977
1926	312	3	637	45	384	0	1,381	4,205	. . .	1,991
1927	560	57	582	63	393	0	1,655	4,092	. . .	2,006
1928	197	31	1,056	24	500	0	1,809	3,854	. . .	2,012
1929	488	23	632	34	405	0	1,583	3,997	. . .	2,022
1930	686	43	251	21	372	0	1,373	4,306	. . .	2,027
1931	775	42	638	20	378	0	1,853	4,173	. . .	2,035
1932	1,851	4	235	14	41	0	2,145	4,226	. . .	2,204
1933	2,435	2	98	15	137	0	2,688	4,036	. . .	2,303
1934	2,430	0	7	5	21	0	2,463	8,238	. . .	2,511
1935	2,430	1	5	12	38	0	2,486	10,125	. . .	2,476
1936	2,430	0	3	39	28	0	2,500	11,258	. . .	2,532
1937	2,564	0	10	19	19	0	2,612	12,760	. . .	2,637
1938	2,564	0	4	17	16	0	2,601	14,512	. . .	2,798
1939	2,484	0	7	91	11	0	2,593	17,644	. . .	2,963
1940	2,184	0	3	80	8	0	2,274	21,995	. . .	3,087
1941	2,254	0	3	94	10	0	2,361	22,737	. . .	3,247
1942	6,189	0	6	471	14	0	6,679	22,726	. . .	3,648
1943	11,543	0	5	681	10	0	12,239	21,938	. . .	4,094
1944	18,846	0	80	815	4	0	19,745	20,619	. . .	4,131
1945	24,262	0	249	578	2	0	25,091	20,065	. . .	4,339
1946	23,350	0	163	580	1	0	24,093	20,529	. . .	4,562
1947	22,559	0	85	535	1	0	23,181	22,754	. . .	4,562
1948	23,333	0	223	541	1	0	24,097	24,244	. . .	4,589
1949	18,885	0	78	534	2	0	19,499	24,427	. . .	4,598
1950	20,725	53	67	1,368	3	0	22,216	22,706	. . .	4,636
1951	23,605	196	19	1,184	5	0	25,009	22,695	. . .	4,709
1952	24,034	663	156	967	4	0	25,825	23,187	. . .	4,812
1953	25,318	598	28	935	2	0	26,880	22,030	. . .	4,894
1954	24,888	44	143	808	1	0	25,885	21,713	. . .	4,985
1955	24,391	394	108	1,585	29	0	26,507	21,690	. . .	5,008
1956	24,610	305	50	1,665	70	0	26,699	21,949	. . .	5,066
1957	23,719	519	55	1,424	66	0	25,784	22,781	. . .	5,146
1958	26,252	95	64	1,296	49	0	27,755	20,534	. . .	5,234
1959	26,607	41	458	1,590	75	0	28,771	19,456	. . .	5,311

For notes, refer to end of table.

6C.—*continued*

Factors absorbing reserve funds								Member bank reserves[9]			
Currency in circulation	Treasury cash holdings[8]	Deposits with Federal Reserve Banks, other than reserve balances			Other Federal Reserve accounts[5]	Required clearing balances	Other Federal Reserve liabilities and capital[5]				
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin[10]	Required[11]	Excess[11, 12]
4,951	288	51	96	25	118	0	0	1,636	. . .	1,585	51
5,091	385	31	73	28	208	0	0	1,890	. . .	1,822	68
5,325	218	57	5	18	298	0	0	1,781	. . .	. . .	. . .
4,403	214	96	12	15	285	0	0	1,753	. . .	1,654	99
4,530	225	11	3	26	276	0	0	1,934	. . .	. . .	. . .
4,757	213	38	4	19	275	0	0	1,898	. . .	1,884	14
4,760	211	51	19	20	258	0	0	2,220	. . .	2,161	59
4,817	203	16	8	21	272	0	0	2,212	. . .	2,256	−44
4,808	201	17	46	19	293	0	0	2,194	. . .	2.250	−56
4,716	208	18	5	21	301	0	0	2,487	. . .	2,424	63
4,686	202	23	6	21	348	0	0	2,389	. . .	2,430	−41
4,578	216	29	6	24	393	0	0	2,355	. . .	2,428	−73
4,603	211	19	6	22	375	0	0	2,471	. . .	2,375	96
5,360	222	54	79	31	354	0	0	1,961	. . .	1,994	−33
5,388	272	8	19	24	355	0	0	2,509	. . .	1,933	576
5,519	284	3	4	128	360	0	0	2,729	. . .	1,870	859
5,536	3,029	121	20	169	241	0	0	4,096	. . .	2,282	1,814
5,882	2,566	544	29	226	253	0	0	5,587	. . .	2,743	2,844
6,543	2,376	244	99	160	261	0	0	6,606	. . .	4,622	1,984
6,550	3,619	142	172	235	263	0	0	7,027	. . .	5,815	1,212
6,856	2,706	923	199	242	260	0	0	8,724	. . .	5,519	3,205
7,598	2,409	634	397	256	251	0	0	11,653	. . .	6,444	5,209
8,732	2,213	368	1,133	599	284	0	0	14,026	. . .	7,411	6,615
11,160	2,215	867	774	586	291	0	0	12,450	. . .	9,365	3,085
15,410	2,193	799	793	485	256	0	0	13,117	. . .	11,129	1,988
20,449	2,303	579	1,360	356	339	0	0	12,886	. . .	11,650	1,236
25,307	2,375	440	1,204	394	402	0	0	14,373	. . .	12,748	1,625
28,515	2,287	977	862	446	495	0	0	15,915	. . .	14,457	1,458
28,952	2,272	393	508	314	607	0	0	16,139	. . .	15,577	562
28,868	1,336	870	392	569	563	0	0	17,899	. . .	16,400	1,499
28,224	1,325	1,123	642	547	590	0	0	20,479	. . .	19,277	1,202
27,600	1,312	821	767	750	706	0	0	16,568	. . .	15,550	1,018
27,741	1,293	668	895	565	714	0	0	17,681	. . .	16,509	1,172
29,206	1,270	247	526	363	746	0	0	20,056	. . .	19,667	389
30,433	1,270	389	550	455	777	0	0	19,950	. . .	20,520	−570
30,781	761	346	423	493	839	0	0	20,160	. . .	19,397	763
30,509	796	563	490	441	907	0	0	18,876	. . .	18,618	258
31,158	767	394	402	554	925	0	0	19,005	. . .	18,903	102
31,790	775	441	322	426	901	0	0	19,059	. . .	19,089	−30
31,834	761	481	356	246	998	0	0	19,034	. . .	19,091	−57
32,193	683	358	272	391	1,122	0	0	18,504	. . .	18,574	−70
32,591	391	504	345	694	841	0	0	18,174	310	18,619	−135

6C. Reserves of Depository Institutions, Federal Reserve Bank Credit, and Related Items, Year-End 1918–1983—*continued*

Millions of dollars

Period	Factors supplying reserve funds									
	Federal Reserve Bank credit outstanding							Gold stock [6]	Special drawing rights certificate account	Treasury currency out-standing [7]
	Securities held outright [1]	Repur-chase agree-ments [2]	Loans	Float [3]	All other [4]	Other Federal Reserve assets [5]	Total			
1960	26,984	400	33	1,847	74	0	29,338	17,767	. . .	5,398
1961	28,722	159	130	2,300	51	0	31,362	16,889	. . .	5,585
1962	30,478	342	38	2,903	110	0	33,871	15,978	. . .	5,567
1963	33,582	11	63	2,600	162	0	36,418	15,513	. . .	5,578
1964	36,506	538	186	2,606	94	0	39,930	15,388	. . .	5,405
1965	40,478	290	137	2,248	187	0	43,340	13,733	. . .	5,575
1966	43,655	661	173	2,495	193	0	47,177	13,159	. . .	6,317
1967	48,980	170	141	2,576	164	0	52,031	11,982	. . .	6,784
1968	52,937	0	186	3,443	58	0	56,624	10,367	. . .	6,795
1969	57,154	0	183	3,440	64	2,743	63,584	10,367	. . .	6,852
1970	62,142	0	335	4,261	57	1,123	67,918	10,732	400	7,147
1971	69,481	1,323	39	4,343	261	1,068	76,515	10,132	400	7,710
1972	71,119	111	1,981	3,974	106	1,260	78,551	10,410	400	8,313
1973	80,395	100	1,258	3,099	68	1,152	86,072	11,567	400	8,716
1974	84,760	954	299	2,001	999	3,195	92,208	11,652	400	9,253
1975	92,789	1,335	211	3,688	1,126	3,312	102,461	11,599	500	10,218
1976	100,062	4,031	25	2,601	991	3,182	110,892	11,598	1,200	10,810
1977	108,922	2,352	265	3,810	954	2,442	118,745	11,718	1,250	11,331
1978	117,374	1,217	1,174	6,432	587	4,543	131,327	11,671	1,300	11,831
1979	124,507	1,660	1,454	6,767	704	5,613	140,705	11,172	1,800	13,083
1980	128,038	2,554	1,809	4,467	776	8,739	146,383	11,160	2,518	13,427
1981	136,863	3,485	1,601	1,762	195	9,230	153,136	11,151	3,318	13,687
1982	144,544	4,293	717	2,735	1,480	9,890	163,659	11,148	4,618	13,786
1983	159,203	1,592	918	1,605	418	8,728	172,464	11,121	4,618	15,732

NOTE: For a description of figures and discussion of their significance, see *Banking and Monetary Statistics, 1941–1970* (Board of Governors of the Federal Reserve System, 1976), pp. 507–23.

Components may not sum to totals because of rounding.

1. In 1969 and thereafter, includes securities loaned—fully guaranteed by U.S. government securities pledged with Federal Reserve Banks—and excludes securities sold and scheduled to be bought back under matched sale–purchase transactions. On September 29, 1971, and thereafter, includes federal agency issues bought outright.

2. On December 1, 1966, and thereafter, includes federal agency obligations held under repurchase agreements.

3. In 1960 and thereafter, figures reflect a minor change in concept; refer to *Federal Reserve Bulletin*, vol. 47 (February 1961), p. 164.

4. Principally acceptances and, until August 21, 1959, industrial loans, the authority for which expired on that date.

5. For the period before April 16, 1969, includes the total of Federal Reserve capital paid in, surplus, other capital accounts, and other liabilities and accrued dividends, less the sum of bank premises and other assets, and is reported as "Other Federal Reserve accounts"; thereafter, "Other Federal Reserve assets" and "Other Federal Reserve liabilities and capital" are shown separately.

6. Before January 30, 1934, includes gold held in Federal Reserve Banks and in circulation.

7. Includes currency and coin (other than gold) issued directly by the Treasury. The largest components are fractional and dollar coins. For details refer to "U.S. Currency and Coin Outstanding and in Circulation," *Treasury Bulletin*.

8. Coin and paper currency held by the Treasury, as well as any gold in excess of the gold certificates issued to the Federal Reserve Banks.

6C.—*continued*

Factors absorbing reserve funds								Member bank reserves [9]			
Currency in circulation	Treasury cash holdings [8]	Deposits with Federal Reserve Banks, other than reserve balances			Other Federal Reserve accounts [5]	Required clearing balances	Other Federal Reserve liabilities and capital [5]				
		Treasury	Foreign	Other				With Federal Reserve Banks	Currency and coin [10]	Required [11]	Excess [11, 12]
32,869	377	485	217	533	941	0	0	17,081	2,544	18,988	637
33,918	422	465	279	320	1,044	0	0	17,387	2,823	20,114	96
35,338	380	597	247	393	1,007	0	0	17,454	3,262	20,071	645
37,692	361	880	171	291	1,065	0	0	17,049	4,099	20,677	471
39,619	612	820	229	321	1,036	0	0	18,086	4,151	21,663	574
42,056	760	668	150	355	211	0	0	18,447	4,163	22,848	−238
44,663	1,176	416	174	588	−147	0	0	19,779	4,310	24,321	−232
47,226	1,344	1,123	135	653	−773	0	0	21,092	4,631	25,905	−182
50,961	695	703	216	747	−1,353	0	0	21,818	4,921	27,439	−700
53,950	596	1,312	134	807	0	0	1,919	22,085	5,187	28,173	−901
57,093	431	1,156	148	1,233	0	0	1,986	24,150	5,423	30,033	−460
61,068	460	2,020	294	999	0	0	2,131	27,788	5,743	32,496	1,035
66,516	345	1,855	325	840	0	0	2,143	25,647	6,216	32,044	98 [12]
72,497	317	2,542	251	1,419 [13]	0	0	2,669	27,060	6,781	35,268	−1,360
79,743	185	3,113	418	1,275 [13]	0	0	2,935	25,843	7,370	37,011	−3,798
86,547	483	7,285	353	1,090	0	0	2,968	26,052	8,036	35,197	−1,103 [14]
93,717	460	10,393	352	1,357	0	0	3,063	25,158	8,628	35,461	−1,535
103,811	392	7,114	379	1,187	0	0	3,292	26,870	9,421	37,615	−1,265
114,645	240	4,196	368	1,256	0	0	4,275	31,152	10,538	42,694	−893
125,600	494	4,075	429	1,412	0	0	4,957	29,792	11,429	44,217	−2,835
136,829	441	3,062	411	617	0	0	4,671	27,456	13,654	40,558	675
144,774	443	4,301	505	781	0	117	5,261	25,111	15,576	42,145	−1,442
154,908	429	5,033	328	1,033	0	436	4,990	26,053	16,666	41,391	1,328
171,935	479	3,661	191	851	0	1,013	5,392	20,413	17,821	39,179	−945

9. In November 1979 and thereafter, includes reserves of member banks, Edge Act corporations, and U.S. agencies and branches of foreign banks. On November 13, 1980, and thereafter, includes reserves of all depository institutions.

10. Between December 1, 1959, and November 23, 1960, part was allowed as reserves; thereafter, all was allowed.

11. Estimated through 1958. Before 1929, data were available only on call dates (in 1920 and 1922 the call date was December 29). Since September 12, 1968, the amount has been based on close-of-business figures for the reserve period two weeks before the report date.

12. For the week ending November 15, 1972, and thereafter, includes $450 million of reserve deficiencies on which Federal Reserve Banks are allowed to waive penalties for a transition period in connection with bank adaptation to Regulation J as amended, effective November 9, 1972. Allowable deficiencies are as follows (beginning with first statement week of quarter, in millions):
1973—Q1, $279; Q2, $172; Q3, $112; Q4, $84; 1974—Q1, $67; Q2, $58. The transition period ended with the second quarter of 1974.

13. For the period before July 1973, includes certain deposits of domestic nonmember banks and foreign-owned banking institutions held with member banks and redeposited in full with Federal Reserve Banks in connection with voluntary participation by nonmember institutions in the Federal Reserve System program of credit restraint.

As of December 12, 1974, the amount of voluntary nonmember bank and foreign-agency and branch deposits at Federal Reserve Banks that are associated with marginal reserves is no longer reported. However, two amounts are reported: (1) deposits voluntarily held as reserves by agencies and branches of foreign banks operating in the United States and (2) Eurodollar liabilities.

14. Adjusted to include waivers of penalties for reserve deficiencies, in accordance with change in Board policy, effective November 19, 1975.

. . . Not applicable.

7. Principal Assets and Liabilities of Insured Commercial Banks, by Class of Bank, June 30, 2009 and 2008

Millions of dollars, except as noted

Item	Total	Member banks			Nonmember banks
		Total	National	State	
	2009				
Assets					
Loans and investments	8,242,525	6,603,156	5,414,831	1,188,324	1,639,369
Loans, gross	6,238,178	4,933,967	4,048,111	885,855	1,304,212
Net	6,236,251	4,933,145	4,047,608	885,538	1,303,106
Investments	2,004,347	1,669,189	1,366,720	302,469	335,157
U.S. Treasury and federal agency securities	249,742	172,378	123,917	48,461	77,364
Other	1,754,605	1,496,811	1,242,803	254,008	257,793
Cash assets, total	616,817	486,640	379,577	107,063	130,177
Liabilities					
Deposits, total	6,548,003	5,080,082	4,138,166	941,915	1,467,923
Interbank	138,690	115,112	98,410	16,702	23,579
Other transactions	777,883	590,658	468,298	122,360	187,225
Other nontransactions	5,631,430	4,374,312	3,571,458	802,853	1,257,119
Equity capital	1,248,933	1,040,431	861,942	178,490	208,501
Number of banks	6,963	2,346	1,502	844	4,617
	2008				
Assets					
Loans and investments	7,696,306	6,110,972	4,971,826	1,139,146	1,585,334
Loans, gross	6,065,897	4,785,033	3,904,189	880,844	1,280,864
Net	6,063,723	4,783,573	3,902,917	880,656	1,280,150
Investments	1,630,409	1,325,939	1,067,637	258,302	304,470
U.S. Treasury and federal agency securities	182,763	98,709	58,602	40,107	84,054
Other	1,447,646	1,227,230	1,009,035	218,195	220,416
Cash assets, total	299,958	235,950	199,712	36,238	64,007
Liabilities					
Deposits, total	5,815,619	4,428,353	3,590,979	837,374	1,387,266
Interbank	99,272	81,821	71,891	9,930	17,451
Other transactions	637,836	461,841	372,625	89,216	175,994
Other nontransactions	5,078,511	3,884,690	3,146,463	738,228	1,193,821
Equity capital	1,146,283	947,154	781,583	165,571	199,128
Number of banks	7,174	2,445	1,582	863	4,729

Note: Includes U.S.-insured commercial banks located in the United States but not U.S.-insured commercial banks operating in U.S. territories or possessions. Data are domestic assets and liabilities (except for those components reported on a consolidated basis only). Components may not sum to totals because of rounding. Data for 2008 have been revised.

8. Initial Margin Requirements under Regulations T, U, and X

Percent of market value

Effective date	Margin stocks	Convertible bonds	Short sales, T only[1]
1934, Oct. 1	25–45	. . .	. . .
1936, Feb. 1	25–55	. . .	. . .
1936, Apr. 1	55	. . .	. . .
1937, Nov. 1	40	. . .	50
1945, Feb. 5	50	. . .	50
1945, July 5	75	. . .	75
1946, Jan. 21	100	. . .	100
1947, Feb. 1	75	. . .	75
1949, Mar. 3	50	. . .	50
1951, Jan. 17	75	. . .	75
1953, Feb. 20	50	. . .	50
1955, Jan. 4	60	. . .	60
1955, Apr. 23	70	. . .	70
1958, Jan. 16	50	. . .	50
1958, Aug. 5	70	. . .	70
1958, Oct. 16	90	. . .	90
1960, July 28	70	. . .	70
1962, July 10	50	. . .	50
1963, Nov. 6	70	. . .	70
1968, Mar. 11	70	50	70
1968, June 8	80	60	80
1970, May 6	65	50	65
1971, Dec. 6	55	50	55
1972, Nov. 24	65	50	65
1974, Jan. 3	50	50	50

NOTE: These regulations, adopted by the Board of Governors pursuant to the Securities Exchange Act of 1934, limit the amount of credit that may be extended for the purpose of purchasing or carrying margin securities (as defined in the regulations) when the loan is collateralized by such securities. The margin requirement, expressed as a percentage, is the difference between the market value of the securities being purchased or carried (100 percent) and the maximum loan value of the collateral as prescribed by the Board. Regulation T was adopted effective October 1, 1934; Regulation U, effective May 1, 1936; and Regulation X, effective November 1, 1971. The former Regulation G, which was adopted effective March 11, 1968, was merged into Regulation U, effective April 1, 1998.

1. From October 1, 1934, to October 31, 1937, the requirement was the margin customarily required by the brokers and dealers.

. . . Not applicable.

9A. Statement of Condition of the Federal Reserve Banks, by Bank, December 31, 2009 and 2008

Millions of dollars

Item	Total		Boston	
	2009	2008	2009	2008
ASSETS				
Gold certificate account	11,037	11,037	412	424
Special drawing rights certificate account	5,200	2,200	196	115
Coin	2,053	1,688	64	56
Loans and securities				
Term auction credit	75,918	450,220	4,052	16,150
Primary, secondary, and seasonal loans	20,700	93,790	109	243
Primary Dealer Credit Facility[1]	...	37,404	...	...
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility	...	23,765	...	23,765
Term Asset-Backed Securities Loan Facility (TALF)[2]	47,626	...	...	...
Credit extended to American International Group, Inc., net[3]	21,250	38,914	...	...
Securities purchased under agreements to resell (tri-party)[4]	...	80,000	...	3,356
U.S. Treasury securities, bought outright[5]	776,588	475,921	14,897	19,962
Government-sponsored enterprise debt securities, bought outright[5]	159,879	19,708	3,067	827
Federal agency and government-sponsored enterprise mortgage-backed securities, bought outright	908,371	...	17,425	...
Total loans and securities	2,010,332	1,219,722	39,550	64,302
Net portfolio holdings of consolidated limited liability companies (LLCs):[6]	81,380	411,996	...	...
Preferred securities[7]	25,106	...	...	...
Investments denominated in foreign currencies[8]	25,272	24,804	1,012	1,411
Central bank liquidity swaps[9]	10,272	553,728	411	31,498
Other assets				
Items in process of collection	611	1,377	19	41
Bank premises	2,249	2,194	121	123
All other assets[10]	65,459	19,789	1,274	842
Interdistrict settlement account	0	0	25,668	–10,264
Total assets	**2,238,971**	**2,248,534**	**68,728**	**88,547**
LIABILITIES				
Federal Reserve notes outstanding (issued to Bank)	1,080,987	1,022,850	35,787	38,282
Less: Notes held by Federal Reserve Bank	193,141	169,682	3,618	5,409
Federal Reserve notes, net	887,846	853,168	32,169	32,872
Securities sold under agreements to repurchase[4]	77,732	88,352	1,491	3,706
Deposits				
Depository institutions	976,988	860,000	32,934	49,810
U.S. Treasury, general account	186,632	106,123	...	...
U.S. Treasury, supplementary financing account[11]	5,001	259,325	...	...
Foreign, official accounts	2,411	1,365	2	2
Other[12]	35,627	21,226	18	246
Total deposits	1,206,659	1,248,039	32,954	50,057
Other liabilities				
Deferred credit items	2,206	2,868	56	69
Consolidated LLCs[13]	6,411	5,813	...	...
All other liabilities[14]	6,836	8,143	169	154
Total liabilities	**2,187,690**	**2,206,382**	**66,839**	**86,859**
CAPITAL ACCOUNTS				
Capital paid in	25,640	21,076	944	844
Surplus (including accumulated other comprehensive loss)	25,640	21,076	944	844
Total liabilities and capital accounts	**2,238,971**	**2,248,534**	**68,728**	**88,547**

For notes see end of table.

9A.—*continued*

New York		Philadelphia		Cleveland		Richmond	
2009	2008	2009	2008	2009	2008	2009	2008
3,895	3,935	450	453	467	423	882	891
1,818	874	210	83	237	104	412	147
77	76	165	137	154	136	293	233
58,254	220,434	1,613	38,300	751	15,575	995	75,130
19,504	80,231	122	329	1	48	102	452
. . .	37,404	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
47,626	. . .	. . .	. . .	. . .	. . .	. . .	. . .
21,250	38,914	. . .	. . .	. . .	. . .	. . .	. . .
. . .	28,464	. . .	3,493	. . .	3,034	. . .	7,254
303,549	169,330	12,048	20,779	30,681	18,047	27,986	43,156
62,493	7,012	2,480	860	6,317	747	5,762	1,787
355,060		14,093	. . .	35,888	. . .	32,735	. . .
867,735	581,788	30,356	63,762	73,638	37,450	67,579	127,779
81,380	411,996	. . .	. . .	. . .	. . .	. . .	. . .
25,106	. . .	. . .	. . .	. . .	. . .	. . .	. . .
6,724	6,209	2,776	2,438	1,861	1,736	7,171	6,717
2,733	138,622	1,128	54,424	756	38,749	2,915	149,945
0	0	51	237	182	164	9	41
263	212	71	65	144	147	239	233
25,557	8,791	1,338	812	2,541	693	2,748	1,919
120,324	110,091	35,084	–66,458	–19,789	16,708	111,074	–163,991
1,135,612	**1,262,593**	**71,630**	**55,952**	**60,192**	**96,310**	**193,321**	**123,914**
398,052	357,738	38,422	41,218	44,922	46,503	82,410	80,772
71,925	46,609	5,591	5,013	7,535	7,240	10,026	11,552
326,127	311,129	32,831	36,205	37,387	39,263	72,384	69,220
30,383	31,435	1,206	3,858	3,071	3,350	2,801	8,012
525,907	509,858	31,597	10,565	15,198	49,963	103,288	34,057
186,632	106,123	. . .	. . .	. . .	. . .	. . .	. . .
5,001	259,325	. . .	. . .	. . .	. . .	. . .	. . .
2,382	1,335	4	4	3	3	11	11
34,787	20,536	0	15	24	3	61	82
754,710	897,177	31,602	10,584	15,225	49,969	103,360	34,150
14	0	220	515	422	456	73	172
6,411	5,813	. . .	. . .	. . .	. . .	. . .	. . .
3,083	5,823	168	160	267	168	423	401
1,120,728	**1,251,378**	**66,026**	**51,322**	**56,371**	**93,206**	**179,042**	**111,954**
7,442	5,607	2,802	2,315	1,910	1,552	7,140	5,980
7,442	5,607	2,802	2,315	1,910	1,552	7,140	5,980
1,135,612	**1,262,593**	**71,630**	**55,952**	**60,192**	**96,310**	**193,321**	**123,914**

9A. Statement of Condition of the Federal Reserve Banks, by Bank, December 31, 2009 and 2008—*continued*

Millions of dollars

Item	Atlanta		Chicago	
	2009	2008	2009	2008
ASSETS				
Gold certificate account	1,356	1,221	911	913
Special drawing rights certificate account	654	166	424	212
Coin	220	214	301	194
Loans and securities				
Term auction credit	363	17,222	1,934	5,094
Primary, secondary, and seasonal loans	175	483	459	1,828
Primary Dealer Credit Facility[1]	...	...	...	...
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility	...	...	...	...
Term Asset-Backed Securities Loan Facility (TALF)[2]	...	...	...	...
Credit extended to American International Group, Inc., net[3]	...	...	...	...
Securities purchased under agreements to resell (tri-party)[4]	...	7,960	...	7,061
U.S. Treasury securities, bought outright[5]	93,568	47,353	84,035	42,005
Government-sponsored enterprise debt securities, bought outright[5]	19,263	1,961	17,301	1,739
Federal agency and government-sponsored enterprise mortgage-backed securities, bought outright	109,446	...	98,296	...
Total loans and securities	222,815	74,979	202,025	57,726
Net portfolio holdings of consolidated LLCs[6]	...	...	...	...
Preferred securities[7]	...	...	...	...
Investments denominated in foreign currencies[8]	1,933	1,910	844	1,100
Central bank liquidity swaps[9]	785	42,641	343	24,559
Other assets				
Items in process of collection	178	325	31	111
Bank premises	221	225	207	209
All other assets[10]	7,719	1,578	6,902	1,316
Interdistrict settlement account	–83,531	20,108	–75,509	34,760
Total assets	**152,351**	**143,366**	**136,478**	**121,100**
LIABILITIES				
Federal Reserve notes outstanding (issued to Bank)	136,496	129,432	85,293	83,073
Less: Notes held by Federal Reserve Bank	32,645	24,156	12,092	12,938
Federal Reserve notes, net	103,851	105,276	73,201	70,135
Securities sold under agreements to repurchase[4]	9,366	8,791	8,411	7,798
Deposits				
Depository institutions	34,951	25,593	52,624	41,013
U.S. Treasury, general account	...	...	...	...
U.S. Treasury, supplementary financing account[11]	...	...	...	...
Foreign, official accounts	3	3	1	2
Other[12]	176	13	244	133
Total deposits	35,130	25,610	52,869	41,147
Other liabilities				
Deferred credit items	218	158	178	323
Consolidated LLCs[13]	...	...	...	...
All other liabilities[14]	624	307	579	290
Total liabilities	**149,189**	**140,143**	**135,239**	**119,693**
CAPITAL ACCOUNTS				
Capital paid in	1,581	1,612	619	703
Surplus (including accumulated other comprehensive loss)	1,581	1,612	619	703
Total liabilities and capital accounts	**152,351**	**143,366**	**136,478**	**121,100**

9A.—*continued*

St. Louis		Minneapolis		Kansas City		Dallas		San Francisco	
2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
329	344	197	199	335	349	621	636	1,182	1,249
150	71	90	30	153	66	282	98	574	234
32	43	62	54	140	114	214	180	329	252
593	4,698	214	5,737	941	2,740	390	4,335	5,818	44,805
26	454	28	123	7	4,570	2	692	166	4,338
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	2,765	. . .	1,510	. . .	2,937	. . .	3,318	. . .	8,849
30,424	16,446	12,857	8,985	35,055	17,475	37,549	19,742	93,939	52,642
6,263	681	2,647	372	7,217	724	7,730	818	19,339	2,180
35,586	. . .	15,038	. . .	41,003	. . .	43,921	. . .	109,880	. . .
72,892	25,044	30,784	16,727	84,223	28,446	89,593	28,905	229,142	112,814
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
251	242	389	477	249	261	325	489	1,737	1,815
102	5,401	158	10,641	101	5,825	132	10,908	706	40,517
19	17	26	76	24	14	33	152	39	199
136	132	111	112	268	273	253	251	214	213
2,523	538	1,084	327	2,896	566	3,121	661	7,756	1,746
–35,273	3,210	–8,558	–9,656	–30,440	5,080	–17,174	11,155	–21,875	49,257
41,162	**35,041**	**24,342**	**18,987**	**57,950**	**40,993**	**77,399**	**53,434**	**219,804**	**208,296**
31,054	29,317	19,330	17,523	28,699	29,868	63,373	55,888	117,148	113,237
4,106	3,405	2,628	2,839	3,022	3,536	13,731	20,767	26,221	26,219
26,948	25,912	16,702	14,684	25,677	26,332	49,642	35,121	90,927	87,018
3,045	3,053	1,287	1,668	3,509	3,244	3,758	3,665	9,403	9,773
10,315	5,446	4,502	1,614	27,940	10,769	22,826	13,533	114,905	107,779
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
0	0	1	1	0	0	1	1	3	3
61	14	19	38	54	14	54	104	128	29
10,377	5,460	4,522	1,652	27,994	10,784	22,881	13,638	115,036	107,810
67	47	271	235	112	102	109	296	466	495
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
245	150	137	99	239	116	303	172	599	302
40,682	**34,622**	**22,918**	**18,338**	**57,531**	**40,578**	**76,694**	**52,892**	**216,430**	**205,398**
240	210	712	324	210	208	353	271	1,687	1,449
240	210	712	324	210	208	353	271	1,687	1,449
41,162	**35,041**	**24,342**	**18,987**	**57,950**	**40,993**	**77,399**	**53,434**	**219,804**	**208,296**

9A. Statement of Condition of the Federal Reserve Banks, by Bank, December 31, 2009 and 2008—*continued*

NOTE: Components may not sum to totals because of rounding.

1. Includes credit extended to primary dealers and certain London-based primary dealer affiliates.

2. Represents the remaining principal balance. Although the TALF loans are recorded at fair value, the amount necessary to adjust the loans to fair value at December 31, is reported in "All other assets."

3. Includes outstanding principal and capitalized interest net of unamortized deferred commitment fees and allowance for loan restructuring. Excludes credit extended to Maiden Lane II LLC and Maiden Lane III LLC.

4. Contract amount of the agreements.

5. Includes securities loaned—fully collateralized by U.S. Treasury securities, other investment-grade securities, and collateral eligible for tri-party repurchase agreements pledged with Federal Reserve Banks—and excludes securities purchased under agreements to resell.

6. The Federal Reserve Bank of New York is the primary beneficiary of Commercial Paper Funding Facility LLC, TALF LLC, Maiden Lane LLC, Maiden Lane II LLC, and Maiden Lane III LLC and, as a result, the accounts and results of operations of these entities are included in the combined financial statements of the Federal Reserve Banks. For additional details, see the "Key Financial Data for Consolidated LLCs" table in the "Federal Reserve Banks" chapter of this report.

7. In December 2009, the Federal Reserve Bank of New York received preferred interests in two special purpose vehicles, AIA Aurora LLC and ALICO Holdings LLC, in exchange for the reduction of the outstanding balance of revolving credit provided to American International Group, Inc. (AIG).

8. Valued daily at market exchange rates.

9. Dollar value of foreign currency held under these agreements valued at the exchange rate to be used when the foreign currency is returned to the foreign central bank. This consistent exchange rate equals the market exchange rate used when the foreign currency was acquired from the foreign central bank.

10. Includes premiums on securities, accrued interest, amount necessary to adjust TALF loans to fair value, and depository institution overdrafts.

11. Represents amounts deposited by the U.S. Treasury that result from a temporary supplementary program that offsets, in part, the reserve impact of the Reserve Banks' lending and liquidity initiatives.

12. Includes deposits of government-sponsored enterprises and international organizations. These deposits are primarily held by the Federal Reserve Bank of New York.

13. The other beneficial interest holders are the U.S. Treasury for TALF LLC, JPMorgan Chase for Maiden Lane LLC, and AIG for Maiden Lane II LLC and Maiden Lane III LLC.

14. Includes discounts on securities and accrued benefit costs.

. . . Not applicable.

9B. Statement of Condition of the Federal Reserve Banks, December 31, 2009 and 2008

Supplemental Information—Collateral Held against Federal Reserve Notes: Federal Reserve Agents' Accounts

Millions of dollars

Item	2009	2008
Federal Reserve notes outstanding	1,080,987	1,022,850
Less: Notes held by Federal Reserve Banks not subject to collateralization	193,141	169,682
Collateralized Federal Reserve notes	**887,846**	**853,168**
Collateral for Federal Reserve notes		
Gold certificate account	11,037	11,037
Special drawing rights certificate account	5,200	2,200
U.S. Treasury securities and government-sponsored enterprise debt securities[1]	858,607	496,733
Other eligible assets	13,002	343,198
Total collateral	**887,846**	**853,168**

1. Face value. Includes compensation to adjust for the effect of inflation on the original face value of inflation-indexed securities, cash value of repurchase agreements, and par value of reverse repurchase agreements.

10. Income and Expenses of the Federal Reserve Banks, by Bank, 2009

Thousands of dollars

Item	Total	Boston	New York	Philadelphia	Cleveland
CURRENT INCOME					
Interest income					
Term auction credit, primary, secondary, and seasonal loans	990,406	34,123	643,900	59,693	18,087
Other loans, net[1]	4,519,461	72,605	4,446,856	...	...
U.S. Treasury securities[2]	22,885,320	546,770	8,779,219	488,305	896,633
Government-sponsored enterprise debt securities	2,047,910	44,976	791,706	38,809	80,512
Federal agency and government-sponsored enterprise mortgage-backed securities	20,406,825	423,278	7,927,495	355,933	804,013
Foreign currencies	296,223	12,404	78,310	32,169	21,698
Central bank liquidity swaps[3]	2,167,618	96,278	567,890	231,611	157,573
Other investments[4]	687	16	264	14	27
Other current income					
Priced services	662,730	...	66,839	...	...
Compensation received for services provided[5]	339,355	21,171	3,530	25,763	35,235
Securities lending fees	112,896	4,090	41,162	4,131	4,326
Other	33,690	14	31,797	386	22
Total current income	**54,463,121**	**1,255,725**	**23,378,969**	**1,236,814**	**2,018,126**
CURRENT EXPENSES					
Interest expense					
Interest expense on securities sold under agreements to repurchase	97,605	2,762	36,781	2,614	3,794
Interest on reserves[6]	2,182,763	76,755	1,117,120	46,031	65,240
Personnel					
Salaries and other personnel expenses	1,610,205	85,331	375,823	74,118	91,600
Retirement and other benefits	564,097	26,915	112,585	30,526	39,475
Net periodic pension expense[7]	662,672	624	658,655	84	−186
Administrative					
Fees	218,417	3,230	98,719	4,193	3,457
Travel	69,157	2,531	9,930	2,621	3,974
Postage and other shipping costs	49,953	383	1,027	545	2,341
Communications	43,941	1,016	5,406	754	922
Materials and supplies	64,567	3,453	17,564	5,087	3,795
Building					
Taxes on real estate	37,306	5,885	5,461	1,589	1,890
Property depreciation	112,398	8,833	16,384	4,865	7,771
Utilities	41,535	4,197	7,362	2,601	2,683
Rent	43,284	1,083	18,595	881	53
Other building	46,117	2,711	7,035	2,730	3,327
Equipment/software					
Purchases	26,593	2,032	4,887	1,230	1,091
Rentals	3,311	326	1,269	423	247
Depreciation	89,459	5,018	9,331	6,196	4,664
Repairs and maintenance	64,826	3,898	6,215	3,353	3,746
Software	144,874	4,548	25,770	8,073	5,041
Other expenses					
Compensation paid for service costs incurred[5]	339,355	...	33,289	...	...
Earnings credits costs	4,344	204	1,234	96	182
Other expenses	74,317	13,177	59,431	8,023	5,346
Recoveries	−126,682	−17,227	−16,870	−4,012	−4,285
Expenses capitalized[8]	−35,255	−3,252	−15,578	−725	−1,126
Total current expenses	**6,429,158**	**234,432**	**2,597,426**	**201,895**	**245,041**
Reimbursements	−450,363	−28,721	−113,405	−32,499	−48,274
Net expenses	5,978,795	205,712	2,484,021	169,396	196,768

For notes see end of table.

10.—*continued*

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
102,155	20,185	18,697	8,051	4,908	5,933	9,669	65,006
...	...	...	...	...	...	...	...
1,083,414	2,658,000	2,381,981	874,687	389,876	993,153	1,074,010	2,719,272
87,462	241,497	216,618	79,074	34,485	90,335	97,302	245,134
811,771	2,429,407	2,180,354	793,004	341,090	909,376	977,096	2,454,008
83,637	22,669	10,238	2,941	4,681	2,943	4,027	20,504
607,777	166,059	78,511	21,456	35,509	21,751	31,710	151,492
32	80	72	26	12	30	32	82
...	525,645	70,246	...	...	...	...	...
32,947	387	34,880	7,249	60,429	52,757	27,910	37,097
8,689	11,828	10,530	4,032	2,065	4,384	4,878	12,781
68	38	87	15	11	251	103	897
2,817,951	**6,075,796**	**5,002,213**	**1,790,535**	**873,067**	**2,080,913**	**2,226,738**	**5,706,274**
5,652	10,940	9,782	3,643	1,707	4,077	4,451	11,402
406,911	79,294	69,210	17,252	7,576	46,029	35,959	215,388
227,716	136,433	117,285	79,719	79,533	97,361	89,261	156,027
79,388	49,556	44,634	27,492	26,014	29,940	36,990	60,581
523	252	437	653	642	385	318	286
60,600	16,399	8,091	6,981	3,001	5,679	1,687	6,381
10,808	7,680	7,550	3,899	2,804	4,562	4,036	8,761
810	36,630	791	833	695	1,071	1,501	3,327
24,178	1,961	1,769	1,373	1,581	1,251	1,919	1,813
5,714	7,256	5,002	2,253	2,089	3,014	4,007	5,333
2,245	3,343	1,262	563	3,560	3,527	3,814	4,167
13,044	10,907	13,152	6,622	4,061	7,564	9,646	9,549
4,723	4,251	2,238	1,749	1,935	2,194	4,127	3,475
17,109	546	1,173	1,517	265	709	210	1,143
4,212	4,140	5,811	2,558	1,774	1,551	6,987	3,281
5,339	1,261	2,592	1,205	1,446	1,773	1,286	2,451
178	457	280	29	7	8	21	65
32,821	5,118	3,268	2,706	1,489	5,426	6,866	6,555
16,394	9,793	4,996	1,659	1,899	2,507	4,324	6,044
54,537	14,060	3,383	3,391	4,483	5,783	8,850	6,954
...	295,468	10,599	...	...	...	...	...
384	253	491	46	117	214	110	1,014
−247,789	56,051	52,339	69,621	20,717	5,666	14,111	17,624
−33,181	−11,363	−9,786	−2,989	−1,651	−6,296	−12,562	−6,460
−2,205	−1,263	−1,191	−489	−4,945	−570	−516	−3,396
690,113	**739,421**	**355,159**	**232,283**	**160,797**	**223,424**	**227,401**	**521,764**
−37,642	−15,103	−4,529	−104,373	−27,848	−10,564	−14,217	−13,188
652,471	724,318	350,630	127,910	132,949	212,861	213,184	508,576

10. Income and Expenses of the Federal Reserve Banks, by Bank, 2009—*continued*

Thousands of dollars

Item	Total	Boston	New York	Philadelphia	Cleveland
PROFIT AND LOSS					
Current net income	48,484,326	1,050,013	20,894,949	1,067,418	1,821,358
Additions to (+) and deductions from (−) current net income					
Profit on sales of federal agency and government-sponsored enterprise mortgage-backed securities	879,305	9,755	354,662	4,845	35,236
Profit (loss) on foreign exchange transactions	172,327	−7,113	58,946	28,558	15,744
Dividends on preferred securities	106,164	...	106,164	...	...
Other loans unrealized gain	557,057	...	557,057	...	...
Net income from consolidated LLCs[9]	5,587,900	...	5,587,900	...	...
Other additions[10]	237,630	2	180,573	0	0
Total additions	7,540,383	2,644	6,845,302	33,403	50,980
Provision for loan loss	0	0	0	0	0
Provision for loan restructuring[11]	−2,620,624	...	−2,620,624	...	...
Other deductions[12]	−99,552	−1	−76,734	0	−15
Total deductions	−2,720,176	−1	−2,697,358	0	−15
Net addition to (+) current net income	4,820,207	2,643	4,147,944	33,403	50,965
Cost of unreimbursed Treasury services	4	0	4	0	0
Assessments by Board					
Board expenditures[13]	386,400	15,221	106,919	42,109	27,661
Cost of currency	502,044	26,432	109,160	29,791	25,057
Net income before distributions	52,416,086	1,011,004	24,826,810	1,028,920	1,819,604
Change in funded status of benefit plans	1,006,813	−10,172	1,030,918	−6,459	−3,365
Comprehensive income before distributions	53,422,899	1,000,832	25,857,728	1,022,461	1,816,239
Dividends paid	1,428,202	54,936	413,037	150,935	99,813
Distributions to U.S. Treasury (interest on Federal Reserve notes)	47,430,237	845,750	23,610,426	384,631	1,358,118
Transferred to/from surplus and change in accumulated other comprehensive income	4,564,460	100,145	1,834,265	486,895	358,308
Surplus, January 1	21,075,873	844,272	5,607,427	2,315,058	1,552,095
Surplus, December 31	25,640,333	944,417	7,441,692	2,801,953	1,910,403

NOTE: Components may not sum to totals because of rounding.

1. Represents interest income on Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Primary Dealer Credit Facility, Term Asset-Backed Securities Loan Facility, and credit extended to American International Group, Inc., net of commitment fees.

2. Includes interest income on securities purchased under agreements to resell.

3. Represents interest income on swap agreements with foreign central banks.

4. Represents interest income on short-term investments related to the federal agency and government-sponsored mortgage-backed securities portfolio.

5. The Federal Reserve Bank of Atlanta has overall responsibility for managing the Reserve Banks' provision of check and ACH services and recognizes total System revenue for these services. The Federal Reserve Bank of New York has overall responsibility for managing the Reserve Banks' provision of Fedwire funds transfer and securities transfer services, and recognizes the total System revenue for these services. The Federal Reserve Bank of Chicago has overall responsibility for managing the Reserve Banks' provision of electronic access services to depository institutions, and recognizes the total System revenue for these services. The Federal Reserve Bank of Atlanta, the Federal Reserve Bank of New York, and the Federal Reserve Bank of Chicago compensate the other Reserve Banks for the costs incurred in providing these services.

6. In October 2008, the Reserve Banks began to pay interest to depository institutions on qualifying balances held at the Federal Reserve Banks.

7. Reflects the effect of the Financial Accounting Standards Board's Codification Topic (ASC 715) Compensation-Retirement Benefits. The System Retirement Plan for employees is recorded on behalf of the System on the books of the Fed-

10.—*continued*

Richmond	Atlanta	Chicago	St. Louis	Minneapolis	Kansas City	Dallas	San Francisco
2,165,480	5,351,478	4,651,583	1,662,625	740,117	1,868,053	2,013,553	5,197,698
14,611	112,503	101,385	35,892	13,831	42,323	44,663	109,599
59,686	12,730	−3,391	1,877	−535	1,156	−3,484	8,155
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
57,025	3	6	0	0	2	15	2
131,322	125,237	98,000	37,769	13,297	43,480	41,194	117,756
0	0	0	0	0	0	0	0
. . .	. . .	. . .	. . .	. . .	. . .	. . .	. . .
-22,802	0	0	0	0	0	0	0
-22,802	0	0	0	0	0	0	0
108,520	125,237	98,000	37,769	13,297	43,480	41,194	117,756
0	0	0	0	0	0	0	0
107,992	28,173	12,791	3,820	7,088	3,661	4,786	26,179
45,300	74,108	46,757	16,892	11,687	18,571	28,090	70,198
2,120,708	5,374,433	4,690,035	1,679,682	734,639	1,889,301	2,021,871	5,219,076
4,508	−1,006	−7,085	8,953	−3,863	−3,032	−2,981	398
2,125,216	5,373,427	4,682,950	1,688,635	730,776	1,886,270	2,018,890	5,219,475
396,167	94,943	44,013	13,821	34,847	12,555	17,301	95,835
569,531	5,309,090	4,722,903	1,644,220	308,255	1,872,070	1,920,056	4,885,186
1,159,518	−30,606	−83,965	30,594	387,674	1,645	81,533	238,455
5,980,154	1,611,672	703,459	209,686	324,373	207,922	270,972	1,448,783
7,139,672	1,581,065	619,494	240,281	712,046	209,566	352,505	1,687,238

eral Reserve Bank of New York. Net pension expense for the System, which was $651,850 thousand, is recorded in the books of the Federal Reserve Bank of New York. The Retirement Benefit Equalization Plan and the Supplemental Employee Retirement Plan are recorded by each Federal Reserve Bank.

8. Includes expenses for labor and materials capitalized and depreciated or amortized as charges to activities in the periods benefited.

9. Represents the portion of the consolidated limited liability companies' net income recorded by the Federal Reserve Bank of New York. The amount includes interest income, interest expenses, realized and unrealized gains and losses, and professional fees.

10. Includes compensation paid by Citigroup, Inc. and Bank of America Corporation for the Federal Reserve Bank of New York's and the Federal Reserve Bank of Richmond's commitments to provide funding support. Costs are reported in "Other deductions."

11. Represents the economic effect of the interest rate reduction made pursuant to the April 17, 2009 restructuring of the AIG credit extension.

12. Includes costs incurred by the Federal Reserve Bank of New York and the Federal Reserve Bank of Richmond related to their commitment to provide funding support to Citigroup, Inc. and Bank of America Corporation. Reimbursement of these costs is reported in "Other additions."

13. For additional details, see the "Board of Governors Financial Statements" in the "Federal Reserve System Audits" section of this report.

. . . Not applicable.

11. Income and Expenses of the Federal Reserve Banks, 1914–2009

Thousands of dollars

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (−)[1]	Assessments by Board of Governors		Change in funded status of benefit plans
				Board expenditures	Costs of currency	
All Banks						
1914–15	2,173	2,018	6	302	...	...
1916	5,218	2,082	−193	192	...	...
1917	16,128	4,922	−1,387	238	...	...
1918	67,584	10,577	−3,909	383	...	...
1919	102,381	18,745	−4,673	595	...	...
1920	181,297	27,549	−3,744	710	...	...
1921	122,866	33,722	−6,315	741	...	...
1922	50,499	28,837	−4,442	723	...	...
1923	50,709	29,062	−8,233	703	...	...
1924	38,340	27,768	−6,191	663	...	...
1925	41,801	26,819	−4,823	709	...	...
1926	47,600	24,914	−3,638	722	1,714	...
1927	43,024	24,894	−2,457	779	1,845	...
1928	64,053	25,401	−5,026	698	806	...
1929	70,955	25,810	−4,862	782	3,099	...
1930	36,424	25,358	−93	810	2,176	...
1931	29,701	24,843	311	719	1,479	...
1932	50,019	24,457	−1,413	729	1,106	...
1933	49,487	25,918	−12,307	800	2,505	...
1934	48,903	26,844	−4,430	1,372	1,026	...
1935	42,752	28,695	−1,737	1,406	1,477	...
1936	37,901	26,016	486	1,680	2,178	...
1937	41,233	25,295	−1,631	1,748	1,757	...
1938	36,261	25,557	2,232	1,725	1,630	...
1939	38,501	25,669	2,390	1,621	1,356	
1940	43,538	25,951	11,488	1,704	1,511	...
1941	41,380	28,536	721	1,840	2,588	...
1942	52,663	32,051	−1,568	1,746	4,826	...
1943	69,306	35,794	23,768	2,416	5,336	...
1944	104,392	39,659	3,222	2,296	7,220	...
1945	142,210	41,666	−830	2,341	4,710	...
1946	150,385	50,493	−626	2,260	4,482	...
1947	158,656	58,191	1,973	2,640	4,562	...
1948	304,161	64,280	−34,318	3,244	5,186	...
1949	316,537	67,931	−12,122	3,243	6,304	...
1950	275,839	69,822	36,294	3,434	7,316	...
1951	394,656	83,793	−2,128	4,095	7,581	...
1952	456,060	92,051	1,584	4,122	8,521	...
1953	513,037	98,493	−1,059	4,100	10,922	...
1954	438,486	99,068	−134	4,175	6,490	...
1955	412,488	101,159	−265	4,194	4,707	...
1956	595,649	110,240	−23	5,340	5,603	...
1957	763,348	117,932	−7,141	7,508	6,374	...
1958	742,068	125,831	124	5,917	5,973	...
1959	886,226	131,848	98,247	6,471	6,384	...

For notes see end of table.

11.—*continued*

Dividends paid	Distributions to U.S. Treasury		Transferred to/from surplus[3]	Transferred to/from surplus and change in accumulated other comprehensive income[6]
	Statutory transfers[2]	Interest on Federal Reserve notes		
217	...	...	...	...
1,743	...	...	...	...
6,804	1,134	...	...	1,134
5,541	...	...	...	48,334
5,012	2,704	...	...	70,652
....				
5,654	60,725	...	...	82,916
6,120	59,974	...	...	15,993
6,307	10,851	...	...	−660
6,553	3,613	...	...	2,546
6,682	114	...	...	−3,078
6,916	59	...	...	2,474
7,329	818	...	...	8,464
7,755	250	...	...	5,044
8,458	2,585	...	...	21,079
9,584	4,283	...	...	22,536
....				
10,269	17	...	...	−2,298
10,030	...	...	...	−7,058
9,282	2,011	...	...	11,021
8,874	...	...	...	−917
8,782	...	...	−60	6,510
8,505	298	...	28	607
7,830	227	...	103	353
7,941	177	...	67	2,616
8,019	120	...	−419	1,862
8,110	25	...	−426	4,534
....				
8,215	82	...	−54	17,617
8,430	141	...	−4	571
8,669	198	...	50	3,554
8,911	245	...	135	40,327
9,500	327	...	201	48,410
10,183	248	...	262	81,970
10,962	67	...	28	81,467
11,523	36	75,284	87	8,366
11,920	...	166,690	...	18,523
12,329	...	193,146	...	21,462
....				
13,083	...	196,629	...	21,849
13,865	...	254,874	...	28,321
14,682	...	291,935	...	46,334
15,558	...	342,568	...	40,337
16,442	...	276,289	...	35,888
17,712	...	251,741	...	32,710
18,905	...	401,556	...	53,983
20,081	...	542,708	...	61,604
21,197	...	524,059	...	59,215
22,722	...	910,650	...	−93,601

11. Income and Expenses of the Federal Reserve Banks, 1914–2009—*continued*

Thousands of dollars

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (−)[1]	Assessments by Board of Governors		Change in funded status of benefit plans
				Board expenditures	Costs of currency	
1960	1,103,385	139,894	13,875	6,534	7,455	. . .
1961	941,648	148,254	3,482	6,265	6,756	. . .
1962	1,048,508	161,451	−56	6,655	8,030	. . .
1963	1,151,120	169,638	615	7,573	10,063	. . .
1964	1,343,747	171,511	726	8,655	17,230	. . .
1965	1,559,484	172,111	1,022	8,576	23,603	. . .
1966	1,908,500	178,212	996	9,022	20,167	. . .
1967	2,190,404	190,561	2,094	10,770	18,790	. . .
1968	2,764,446	207,678	8,520	14,198	20,474	. . .
1969	3,373,361	237,828	−558	15,020	22,126	. . .
1970	3,877,218	276,572	11,442	21,228	23,574	. . .
1971	3,723,370	319,608	94,266	32,634	24,943	. . .
1972	3,792,335	347,917	−49,616	35,234	31,455	. . .
1973	5,016,769	416,879	−80,653	44,412	33,826	. . .
1974	6,280,091	476,235	−78,487	41,117	30,190	. . .
1975	6,257,937	514,359	−202,370	33,577	37,130	. . .
1976	6,623,220	558,129	7,311	41,828	48,819	. . .
1977	6,891,317	568,851	−177,033	47,366	55,008	. . .
1978	8,455,309	592,558	−633,123	53,322	60,059	. . .
1979	10,310,148	625,168	−151,148	50,530	68,391	. . .
1980	12,802,319	718,033	−115,386	62,231	73,124	. . .
1981	15,508,350	814,190	−372,879	63,163	82,924	. . .
1982	16,517,385	926,034	−68,833	61,813	98,441	. . .
1983	16,068,362	1,023,678	−400,366	71,551	152,135	. . .
1984	18,068,821	1,102,444	−412,943	82,116	162,606	. . .
1985	18,131,983	1,127,744	1,301,624	77,378	173,739	. . .
1986	17,464,528	1,156,868	1,975,893	97,338	180,780	. . .
1987	17,633,012	1,146,911	1,796,594	81,870	170,675	. . .
1988	19,526,431	1,205,960	−516,910	84,411	164,245	. . .
1989	22,249,276	1,332,161	1,254,613	89,580	175,044	. . .
1990	23,476,604	1,349,726	2,099,328	103,752	193,007	. . .
1991	22,553,002	1,429,322	405,729	109,631	261,316	. . .
1992	20,235,028	1,474,531	−987,788	128,955	295,401	. . .
1993	18,914,251	1,657,800	−230,268	140,466	355,947	. . .
1994	20,910,742	1,795,328	2,363,862	146,866	368,187	. . .
1995	25,395,148	1,818,416	857,788	161,348	370,203	. . .
1996	25,164,303	1,947,861	−1,676,716	162,642	402,517	. . .
1997	26,917,213	1,976,453	−2,611,570	174,407	364,454	. . .
1998	28,149,477	1,833,436	1,906,037	178,009	408,544	. . .
1999	29,346,836	1,852,162	−533,557	213,790	484,959	. . .
2000	33,963,992	1,971,688	−1,500,027	188,067	435,838	. . .
2001	31,870,721	2,084,708	−1,117,435	295,056	338,537	. . .
2002	26,760,113	2,227,078	2,149,328	205,111	429,568	. . .
2003	23,792,725	2,462,658	2,481,127	297,020	508,144	. . .
2004	23,539,942	2,238,705	917,870	272,331	503,784	. . .
2005	30,729,357	2,889,544	−3,576,903	265,742	477,087	. . .
2006	38,410,427	3,263,844	−158,846	301,014	491,962	. . .
2007	42,576,025	3,510,206	198,417	296,125	576,306	324,481
2008	41,045,582	4,870,374	3,340,628	352,291	500,372	−3,158,808
2009	54,463,121	5,978,795	4,820,204	386,400	502,044	1,006,813
Total, 1914–2009	**848,974,370**	**67,706,631**	**12,401,045**	**5,739,616**	**10,410,734**	**−1,827,514**

11.—*continued*

Dividends paid	Distributions to U.S. Treasury		Transferred to/from surplus[3]	Transferred to/from surplus and change in accumulated other comprehensive income[6]
	Statutory transfers[2]	Interest on Federal Reserve notes		
23,948	. . .	896,816	. . .	42,613
25,570	. . .	687,393	. . .	70,892
27,412	. . .	799,366	. . .	45,538
28,912	. . .	879,685	. . .	55,864
30,782	. . .	1,582,119	. . .	−465,823
32,352	. . .	1,296,810	. . .	27,054
33,696	. . .	1,649,455	. . .	18,944
35,027	. . .	1,907,498	. . .	29,851
36,959	. . .	2,463,629	. . .	30,027
39,237	. . .	3,019,161	. . .	39,432
41,137	. . .	3,493,571	. . .	32,580
43,488	. . .	3,356,560	. . .	40,403
46,184	. . .	3,231,268	. . .	50,661
49,140	. . .	4,340,680	. . .	51,178
52,580	. . .	5,549,999	. . .	51,483
54,610	. . .	5,382,064	. . .	33,828
57,351	. . .	5,870,463	. . .	53,940
60,182	. . .	5,937,148	. . .	45,728
63,280	. . .	7,005,779	. . .	47,268
67,194	. . .	9,278,576	. . .	69,141
70,355	. . .	11,706,370	. . .	56,821
74,574	. . .	14,023,723	. . .	76,897
79,352	. . .	15,204,591	. . .	78,320
85,152	. . .	14,228,816	. . .	106,663
92,620	. . .	16,054,095	. . .	161,996
103,029	. . .	17,796,464	. . .	155,253
109,588	. . .	17,803,895	. . .	91,954
117,499	. . .	17,738,880	. . .	173,771
125,616	. . .	17,364,319	. . .	64,971
129,885	. . .	21,646,417	. . .	130,802
140,758	. . .	23,608,398	. . .	180,292
152,553	. . .	20,777,552	. . .	228,356
171,763	. . .	16,774,477	. . .	402,114
195,422	. . .	15,986,765	. . .	347,583
212,090	. . .	20,470,011	. . .	282,122
230,527	. . .	23,389,367	. . .	283,075
255,884	5,517,716	14,565,624	. . .	635,343
299,652	20,658,972	0	. . .	831,705
343,014	17,785,942	8,774,994	. . .	731,575
373,579	. . .	25,409,736	. . .	479,053
409,614	. . .	25,343,892	. . .	4,114,865
428,183	. . .	27,089,222	. . .	517,580
483,596	. . .	24,495,490	. . .	1,068,598
517,705	. . .	22,021,528	. . .	466,796
582,402	. . .	18,078,003	. . .	2,782,587
780,863	. . .	21,467,545	. . .	1,271,672
871,255	. . .	29,051,678	. . .	4,271,828
992,353	. . .	34,598,401	. . .	3,125,533
1,189,626	. . .	31,688,688	. . .	2,626,053
1,428,202	. . .	47,430,237	. . .	4,564,460
12,348,958	**44,113,958**	**687,645,286**	**–4**	**31,582,722[4]**

11. Income and Expenses of the Federal Reserve Banks, 1914–2009—*continued*

Thousands of dollars

Federal Reserve Bank and period	Current income	Net expenses	Net additions or deductions (−)[1]	Assessments by Board of Governors: Board expenditures	Assessments by Board of Governors: Costs of currency	Change in funded status of benefit plans
Aggregate for each Bank, 1914–2009						
Boston	43,062,237	3,992,881	149,103	248,532	604,816	−13,242
New York	304,907,672	12,959,118[5]	4,788,937	1,437,420	3,124,108	−1,873,938
Philadelphia	31,233,470	3,241,737	615,539	311,463	466,216	−6,258
Cleveland	47,993,734	3,851,063	649,458	416,037	587,999	2,889
Richmond	65,510,304	5,921,622	1,829,706	948,707	867,797	30,135
Atlanta	54,815,334	9,080,562	885,186	431,119	883,931	7,165
Chicago	96,740,142	7,503,350	1,052,372	572,318	1,152,455	3,064
St. Louis	28,405,607	2,976,568	183,368	125,518	376,880	9,824
Minneapolis	14,741,915	2,970,651	240,066	159,353	195,896	2,961
Kansas City	30,064,548	3,994,257	256,754	157,542	386,884	−5,346
Dallas	37,851,916	4,067,776	516,569	233,913	515,061	10,175
San Francisco	93,647,491	7,147,046	1,233,988	697,695	1,248,691	5,055
Total	**848,974,370**	**67,706,631**	**12,401,045**	**5,739,616**	**10,410,734**	**–1,827,514**

NOTE: Components may not sum to totals because of rounding.

1. For 1987 and subsequent years, includes the cost of services provided to the Treasury by Federal Reserve Banks for which reimbursement was not received.

2. Represents transfers made as a franchise tax from 1917 through 1932; transfers made under section 13b of the Federal Reserve Act from 1935 through 1947; and transfers made under section 7 of the Federal Reserve Act for 1996 and 1997.

11.—*continued*

Dividends paid	Distributions to U.S. Treasury		Transferred to/from surplus[3]	Transferred to/from surplus and change in accumulated other comprehensive income[6]
	Statutory transfers[2]	Interest on Federal Reserve notes		
554,883	2,579,504	34,078,800	135	1,138,546
3,143,937	17,307,161	259,978,960	−433	9,872,400
794,701	1,312,118	22,748,368	291	2,967,857
899,444	2,827,043	37,845,642	−10	2,218,863
2,380,997	3,083,928	45,946,850	−72	8,220,316
884,651	2,713,230	39,812,462	5	1,901,724
1,079,245	4,593,811	81,856,222	12	1,038,165
243,679	1,833,837	22,678,317	−27	364,027
331,057	416,227	10,041,556	65	870,139
283,928	1,249,703	23,911,666	−9	331,986
402,176	1,510,802	31,128,376	55	520,501
1,350,260	4,686,594	77,618,065	−17	2,138,200
12,348,958	**44,113,958**	**687,645,286**	**−4**	**31,582,722[4]**

3. Transfers are made under section 13b of the Federal Reserve Act.

4. The $31,582,722 thousand transferred to surplus was reduced by direct charges of $500 thousand for charge-off on Bank premises (1927); $139,300 thousand for contributions to capital of the Federal Deposit Insurance Corporation (1934); $4 thousand net upon elimination of section 13b surplus (1958); $106,000 thousand (1996), $107,000 thousand (1997), and $3,752,000 thousand (2000) transferred to the Treasury as statutorily required; and $1,848,716 thousand related to the implementation of SFAS No. 158 (2006), and was increased by transfer of $11,131 thousand from reserves for contingencies (1955), leaving a balance of $25,640,333 thousand on December 31, 2009.

5. This amount is reduced by $3,604,674 thousand for expenses of the System Retirement Plan. See note 6, table 10.

6. Transfers are made under section 7 of the Federal Reserve Act. Beginning in 2006, accumulated other comprehensive income is reported as a component of surplus.

. . . Not applicable.

12. Operations in Principal Departments of the Federal Reserve Banks, 2006–2009

Operation	2009	2008	2007	2006
Millions of pieces				
Currency processed	31,891	33,256	35,653	37,694
Currency destroyed	6,049	6,517	6,509	6,766
Coin received	65,349	64,438	63,255	59,705
Checks handled				
U.S. government checks[1]	202	269	214	222
Postal money orders	131	146	164	171
All other	8,585	9,545	10,001	11,083
Securities transfers[2]	21	25	24	22
Funds transfers[3]	125	131	135	134
Automated clearinghouse transactions				
Commercial	9,966	10,040	9,363	8,231
Government	1,195	1,132	1,027	992
Millions of dollars				
Currency processed	561,013	604,882	642,168	664,592
Currency destroyed	92,708	148,460	104,082	84,742
Coin received	6,288	6,286	6,124	5,779
Checks handled				
U.S. government checks[1]	311,667	316,713	256,994	269,073
Postal money orders	23,675	25,544	31,626	28,066
All other	13,758,963	15,216,147	14,841,249	16,442,820
Securities transfers[2]	295,741,666	419,347,256	435,577,505	377,258,592
Funds transfers[3]	631,127,108	754,974,633	670,665,569	572,645,790
Automated clearinghouse transactions				
Commercial	15,418,718	15,662,805	14,547,234	13,124,434
Government	4,297,071	4,008,022	3,716,928	3,474,364

1. Includes government checks handled electronically (electronic checks).
2. Data on securities transfers do not include reversals. In 2006, the title of this category changed from previous years, but the composition of the category remained the same. Therefore, the data are comparable with data reported in previous years.
3. Data on funds transfers do not include non-value transfers.

13. Number and Annual Salaries of Officers and Employees of the Federal Reserve Banks, December 31, 2009

Federal Reserve Bank (including Branches)	President[1] Salary (dollars)[2]	Other officers Number	Other officers Salaries (dollars)[2]	Employees Number Full-time	Employees Number Part-time	Employees Salaries (dollars)[2]	Total Number	Total Salaries (dollars)[2]
Boston	320,900	66	12,856,083	744	39	63,516,351	850	76,693,334
New York	410,780	368	85,714,443	2,560	43	254,511,210	2,972	340,636,434
Philadelphia	344,700	58	10,181,633	800	24	55,718,901	883	66,245,234
Cleveland	341,600	57	9,983,500	1,243	22	74,310,639	1,323	84,635,739
Richmond	339,600	80	13,563,800	1,369	27	97,233,037	1,477	111,136,437
Atlanta	302,800	82	15,758,280	1,594	23	111,022,816	1,700	127,083,896
Chicago	308,400	88	15,923,876	1,167	50	93,685,889	1,306	109,918,165
St. Louis	276,800	75	13,394,150	826	35	57,805,258	937	71,476,208
Minneapolis	308,400	48	8,421,035	932	53	62,801,655	1,034	71,531,090
Kansas City	374,400	71	13,256,500	1,099	15	70,636,359	1,186	84,267,259
Dallas	344,700	62	10,568,805	1,067	9	68,950,312	1,139	79,863,817
San Francisco	410,800	76	16,026,698	1,547	17	127,616,719	1,641	144,054,217
Federal Reserve Information Technology	...	43	7,580,500	862	1	81,892,180	906	89,472,680
Office of Employee Benefits	...	9	2,140,500	35	0	3,218,346	44	5,358,846
Total	4,083,880	1,183	235,369,803	15,845	358	1,222,919,672	17,398	1,462,373,355

NOTE: Components may not sum to totals because of rounding.

1. Under current policies, appointment salaries are normally 85 percent of the salary-range mid-point (an 85 compa-ratio), with the exception of the New York Reserve Bank president, whose appointment salary normally is set at a 95 compa-ratio. The Board has discretion to approve a higher starting salary if requested by a Reserve Bank's board of directors. On January 1 each year, all presidents receive salary increases equal to the percentage increase in the mid-point of their respective salary ranges. In addition, on every third-year anniversary of his or her initial appointment (through year 9), each president receives a salary increase that results in a compa-ratio as follows: year 3: 95 (for the New York Bank: 105); year 6: 105 (New York: 115); year 9: 115 (New York: 125). There are tiered salary ranges for Reserve Bank officers, including presidents, reflecting differences in the costs of labor in the head-office cities. The Board reviews Reserve Bank officer salary ranges and Reserve Bank placement in the salary tiers annually. In 2009, New York and San Francisco were in tier 1, which had a mid-point for presidents' salaries of $432,400. Boston, Philadelphia, Chicago, Minneapolis, and Dallas were in tier 2, which had a mid-point for presidents' salaries of $362,800. Cleveland, Richmond, Atlanta, St. Louis, and Kansas City were in tier 3, which had a mid-point for presidents' salaries of $325,600. Salaries for Reserve Bank officers, including presidents, are limited by compensation caps established for each tier. In 2009, the caps were $431,300 for tier 1; $419,600 for tier 2; and $400,000 for tier 3.

2. Annualized salary liability (excluding outside agency costs) based on salaries in effect on December 31, 2009.

. . . Not applicable.

14. Acquisition Costs and Net Book Value of the Premises of the Federal Reserve Banks and Branches, December 31, 2009

Thousands of dollars

Federal Reserve Bank or Branch	Acquisition costs				Net book value	Other real estate[3]
	Land	Buildings (including vaults)[1]	Building machinery and equipment	Total[2]		
BOSTON	27,293	149,884	30,051	207,228	120,794	. . .
NEW YORK	20,103	334,396	71,231	425,729	263,190	. . .
PHILADELPHIA	7,898	102,293	16,275	126,466	70,929	. . .
CLEVELAND	4,219	123,576	29,548	157,343	104,231	. . .
Cincinnati	2,909	27,994	15,177	46,080	21,298	. . .
Pittsburgh	2,751	19,638	15,850	38,240	18,741	. . .
RICHMOND	28,398	149,706	48,653	226,757	159,804	. . .
Baltimore	7,917	38,175	11,603	57,695	36,382	. . .
Charlotte	7,884	40,487	12,682	61,054	42,815	. . .
ATLANTA	22,995	150,579	17,473	191,047	156,918	. . .
Birmingham	5,347	12,896	1,465	19,708	11,597	. . .
Jacksonville	1,779	22,673	4,165	28,616	17,187	. . .
Miami	603	6,398	3,542	10,543	4,434	. . .
Nashville	3,785	10,105	5,174	19,063	9,434	. . .
New Orleans	4,254	26,599	5,778	36,632	21,689	. . .
CHICAGO	4,512	186,509	23,430	214,451	120,340	. . .
Detroit	12,327	72,447	11,029	95,802	87,018	. . .
ST. LOUIS	9,377	134,796	14,996	159,169	123,416	. . .
Memphis	2,472	14,339	5,157	21,968	12,404	. . .
MINNEAPOLIS	15,845	107,874	14,854	138,573	101,115	. . .
Helena	2,890	10,387	1,150	14,426	9,528	. . .
KANSAS CITY	38,320	198,534	27,470	264,324	253,841	. . .
Denver	3,511	9,238	4,622	17,370	7,348	. . .
Omaha	3,559	7,692	1,933	13,184	6,611	. . .
DALLAS	36,526	114,965	30,767	182,258	122,991	. . .
El Paso	262	3,426	1,843	5,531	821	. . .
Houston	25,146	103,875	8,714	137,735	124,143	7,204
San Antonio	826	8,407	2,491	11,724	5,195	. . .
SAN FRANCISCO	20,988	102,700	29,504	153,192	86,358	. . .
Los Angeles	6,306	74,272	18,195	98,773	58,752	. . .
Salt Lake City	1,294	4,788	1,413	7,495	2,690	. . .
Seattle	12,161	52,131	5,498	69,791	66,607	10,089
Total	**344,455**	**2,421,778**	**491,734**	**3,257,967**	**2,248,621**	**17,294**

NOTE: Components may not sum to totals because of rounding.

1. Includes expenditures for construction at some offices, pending allocation to appropriate accounts.
2. Excludes charge-offs of $17,699 thousand before 1952.
3. Includes real estate held for future Bank use and Bank premises formerly occupied and being held pending sale.

. . . Not applicable.

Federal Reserve System Audits

Audits of the Federal Reserve System

The Board of Governors, the Federal Reserve Banks, and the Federal Reserve System as a whole are all subject to several levels of audit and review. The Board's financial statements, and its compliance with laws and regulations affecting those statements, are audited annually by an outside auditor retained by the Board's Office of Inspector General. The Office of Inspector General also conducts audits, reviews, and investigations relating to the Board's programs and operations as well as to Board functions delegated to the Reserve Banks.

The Reserve Banks' financial statements are audited annually by an independent outside auditor retained by the Board of Governors. In addition, the Reserve Banks are subject to annual examination by the Board. As discussed in the chapter "Federal Reserve Banks," the Board's examination includes a wide range of ongoing oversight activities conducted on site and off site by staff of the Board's Division of Reserve Bank Operations and Payment Systems.

Federal Reserve operations are also subject to review by the Government Accountability Office. ■

Board of Governors Financial Statements

The financial statements of the Board of Governors for 2009 and 2008 were audited by Deloitte & Touche LLP, independent auditors.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D.C. 20551

March 19, 2010

MANAGEMENT'S ASSERTION

To the Committee on Board Affairs:

The management of the Board of Governors of the Federal Reserve System ("the Board") is responsible for the preparation and fair presentation of the balance sheet as of December 31, 2009, and for the related statement of revenues and expenses and changes in cumulative results of operations, and cash flows for the year then ended (the "Financial Statements"). The Financial Statements have been prepared in conformity with accounting principles generally accepted in the United States of America and, as such, include some amounts which are based on management judgments and estimates. To our knowledge, the Financial Statements are, in all material respects, fairly presented in conformity with generally accepted accounting principles and include all disclosures necessary for such presentation.

Board management is also responsible for establishing and maintaining effective internal control over financial reporting as it relates to the Financial Statements. Such internal control is designed to provide reasonable assurance to management and to the Committee on Board Affairs regarding the preparation of the Financial Statements in accordance with accounting principles generally accepted in the United States of America. Internal control includes self-monitoring mechanisms, including, but not limited to, divisions of responsibility and a code of conduct. Once identified, any material deficiencies in internal control are reported to management and appropriate corrective measures are implemented.

Even effective internal control—no matter how well designed—has inherent limitations, including the possibility of human error. Internal control, therefore, can provide only reasonable assurance with respect to the preparation of reliable financial statements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that specific controls may become inadequate because of changes in conditions or that the degree of compliance with policies or procedures may deteriorate.

Board management assessed its internal control over financial reporting reflected in the Financial Statements based upon the criteria established in the *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

Based on this assessment, we believe that the Board has maintained effective internal control over financial reporting as it relates to its Financial Statements.

Stephen R. Malphrus
Staff Director for Management

William L. Mitchell
Chief Financial Officer

Deloitte.

INDEPENDENT AUDITORS' REPORT

The Board of Governors of the Federal Reserve System:

We have audited the accompanying balance sheets of the Board of Governors of the Federal Reserve System (the "Board") as of December 31, 2009 and 2008, and the related statements of revenues and expenses and changes in cumulative results of operations, and cash flows for the years then ended. These financial statements are the responsibility of the Board's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States), auditing standards of the Public Company Accounting Oversight Board (United States), and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the respective financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Board of Governors of the Federal Reserve System as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Board's internal control over financial reporting as of December 31, 2009, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 19, 2010 expressed an unqualified opinion on the Board's internal control over financial reporting.

In accordance with *Government Auditing Standards,* we have also issued our report dated March 19, 2010, on our tests of the Board's compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of compliance and the results of that testing, and not to provide an opinion on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte + Touche LLP

McLean, VA
March 19, 2010

Deloitte.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Governors of the Federal Reserve System:

We have audited the internal control over financial reporting of the Board of Governors of the Federal Reserve System (the "Board") as of December 31, 2009, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Board's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Assertion report. Our responsibility is to express an opinion on the Board's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

The Board's internal control over financial reporting is a process designed by, or under the supervision of, the Board's principal executive and principal financial officers, or persons performing similar functions, and effected by the Board's Committee on Board Affairs, management, and other personnel to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. The Board's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Board; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Board are being made only in accordance with authorizations of management and governors of the Board; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Board's assets that could have a material effect on the financial statements.

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Board maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on the criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), generally accepted auditing standards as established by the Auditing Standards Board (United States), and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the accompanying balance sheet, statements of revenues and expenses and changes in cumulative results of operations, and cash flows as of and for the year ended December 31, 2009 of the Board and our report dated March 19, 2010 expressed an unqualified opinion on those financial statements.

Deloitte + Touche LLP

McLean, VA
March 19, 2010

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

BALANCE SHEETS

	As of December 31, 2009	As of December 31, 2008
ASSETS		
CURRENT ASSETS:		
Cash	$ 54,792,831	$ 58,255,990
Accounts receivable	2,948,984	2,975,478
Prepaid expenses and other assets	3,693,970	4,817,719
Total current assets	61,435,785	66,049,187
NONCURRENT ASSETS:		
Property, equipment, and software, net (Note 4)	159,267,605	148,875,490
Other assets	1,837,995	2,187,395
Total noncurrent assets	161,105,600	151,062,885
Total assets	$222,541,385	$217,112,072
LIABILITIES AND CUMULATIVE RESULTS OF OPERATIONS		
CURRENT LIABILITIES:		
Accounts payable and accrued liabilities	$ 20,765,464	$ 13,312,600
Accrued payroll and related taxes	10,940,984	9,313,237
Accrued annual leave	24,821,044	22,234,106
Capital lease payable (Note 4)	533,110	471,266
Unearned revenues and other liabilities	2,982,629	1,843,058
Total current liabilities	60,043,231	47,174,267
LONG-TERM LIABILITIES:		
Capital lease payable (Note 4)	782,357	1,183,466
Accumulated retirement benefit obligation (Note 5)	13,021,387	10,866,659
Accumulated postretirement benefit obligation (Note 6)	9,304,324	8,527,800
Accumulated postemployment benefit obligation (Note 7)	14,463,965	13,900,000
Other long-term liabilities	415,324	648,534
Total long-term liabilities	37,987,357	35,126,459
Total liabilities	98,030,588	82,300,726
CUMULATIVE RESULTS OF OPERATIONS:		
Fund balance	133,677,902	144,085,508
Accumulated other comprehensive income (loss) (Note 8)	(9,167,105)	(9,274,162)
Total cumulative results of operations	124,510,797	134,811,346
Total liabilities and cumulative results of operations	$222,541,385	$217,112,072

See accompanying notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN CUMULATIVE RESULTS OF OPERATIONS

	For the years ended December 31,	
	2009	2008
BOARD OPERATING REVENUES:		
Assessments levied on Federal Reserve Banks for Board operating expenses and capital expenditures	$386,399,900	$352,290,700
Other revenues	9,413,565	9,059,232
Total operating revenues	395,813,465	361,349,932
BOARD OPERATING EXPENSES:		
Salaries	243,664,276	219,752,842
Retirement and insurance	50,458,964	48,394,723
Contractual services and professional fees	40,065,160	29,901,374
Depreciation, amortization, and net losses on disposals	13,885,165	13,782,449
Utilities	8,676,782	9,977,809
Travel	11,346,880	9,414,877
Software	8,699,031	7,277,995
Postage and supplies	8,157,780	5,802,368
Repairs and maintenance	5,115,155	3,214,203
Printing and binding	2,597,982	1,825,119
Other expenses	13,553,896	10,870,638
Total operating expenses	406,221,071	360,214,397
RESULTS OF OPERATIONS	(10,407,606)	1,135,535
CURRENCY COSTS:		
Assessments levied on Federal Reserve Banks for currency costs	502,144,883	500,356,895
Expenses for costs related to currency (Note 9)	502,144,883	500,356,895
CURRENCY ASSESSMENTS OVER (UNDER) EXPENSES	0	0
TOTAL RESULTS OF OPERATIONS	(10,407,606)	1,135,535
CUMULATIVE RESULTS OF OPERATIONS, Beginning of year	134,811,346	141,463,159
OTHER COMPREHENSIVE INCOME (Note 8)		
Prior service credit (cost) arising during the year	(315,842)	(5,059,307)
Amortization of prior service (credit) cost	541,162	73,867
Amortization of net actuarial (gain) loss	353,551	131,578
Net actuarial gain (loss) arising during the year	(471,814)	(3,183,688)
Curtailment effects - prior service credit (cost)	0	250,202
Total Other Comprehensive Income (Loss)	107,057	(7,787,348)
CUMULATIVE RESULTS OF OPERATIONS, End of year	$124,510,797	$134,811,346

See accompanying notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

STATEMENTS OF CASH FLOWS

	For the years ended December 31, 2009	2008
Cash Flows from Operating Activities		
Results of operations	$(10,407,606)	$ 1,135,535
Adjustments to reconcile results of operations to net cash provided by (used in) operating activities:		
Depreciation	13,869,221	13,946,960
Net loss (gain) on disposal of property and equipment	15,944	(164,511)
Decrease (increase) in assets:		
Accounts receivable, prepaid expenses and other assets	1,499,641	(2,164,471)
Increase (decrease) in liabilities:		
Accounts payable and accrued liabilities	1,668,788	(7,087,682)
Accrued payroll and related taxes	1,627,747	3,666,184
Accrued annual leave	2,586,938	3,804,505
Unearned revenues and other liabilities	1,139,571	1,140,936
Accumulated retirement benefit obligation	2,154,728	8,664,984
Accumulated postretirement benefit obligation	776,524	555,331
Accumulated postemployment benefit obligation	563,965	5,044,387
Other long-term liabilities	(233,210)	648,534
Accumulated other comprehensive income	107,057	(7,787,348)
Net cash provided by (used in) operating activities	15,369,308	21,403,344
Cash Flows from Investing Activities		
Proceeds from disposals	866	0
Capital expenditures	(18,346,427)	(9,307,059)
Net cash provided by (used in) investing activities	(18,345,561)	(9,307,059)
Cash Flows from Financing Activities—Capital lease payments	(486,906)	1,545,977
Net cash provided by (used in) financing activities	(486,906)	1,545,977
Net Increase (Decrease) in Cash	(3,463,159)	13,642,262
Cash Balance, Beginning of year	58,255,990	44,613,728
Cash Balance, End of year	$ 54,792,831	$58,255,990

See accompanying notes to financial statements.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2009 AND 2008

(1) Structure

The Federal Reserve System (the System) was established by Congress in 1913 and consists of the Board of Governors (the Board), the Federal Open Market Committee, the twelve regional Federal Reserve Banks, the Federal Advisory Council, and the private commercial banks that are members of the System. The Board, unlike the Reserve Banks, was established as a federal government agency and is supported by Washington, D.C. based staff numbering approximately 2,100, as it carries out its responsibilities in conjunction with other components of the Federal Reserve System.

The Board is required by the Federal Reserve Act (the Act) to report its operations to the Speaker of the House of Representatives. The Act also requires the Board, each year, to order a financial audit of each Federal Reserve Bank and to publish each week a statement of the financial condition of each such Reserve Bank and a consolidated statement for all of the Reserve Banks. Accordingly, the Board believes that the best financial disclosure consistent with law is achieved by issuing separate financial statements for the Board and for the Reserve Banks. Therefore, the accompanying financial statements include only the results of operations and activities of the Board. Combined financial statements for the Federal Reserve Banks are included in the Board's annual report to the Speaker of the House of Representatives.

(2) Operations and Services

The Board's responsibilities require thorough analysis of domestic and international financial and economic developments. The Board carries out those responsibilities in conjunction with other components of the Federal Reserve System. The Board also supervises and regulates the operations of the Federal Reserve Banks, exercises broad responsibility in the nation's payments system, and administers most of the nation's laws regarding consumer credit protection. Policy regarding open market operations is established by the Federal Open Market Committee. However, the Board has sole authority over changes in reserve requirements, and it must approve any change in the discount rate initiated by a Federal Reserve Bank.

The Board also plays a major role in the supervision and regulation of the U.S. banking system. It has supervisory responsibilities for state-chartered banks that are members of the Federal Reserve System, bank holding companies, foreign activities of member banks, and U.S. activities of foreign banks.

(3) Significant Accounting Policies

Basis of Accounting — The Board prepares its financial statements in accordance with accounting principles generally accepted in the United States (GAAP).

Revenues — The Federal Reserve Act authorizes the Board to levy an assessment on the Reserve Banks to fund its operations. The Board levies the assessment based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year.

Currency Costs — The Federal Reserve Board issues the nation's currency (in the form of Federal Reserve notes), and the Federal Reserve Banks distribute currency and coin through depository institutions. The Board incurs expenses and assesses the Reserve Banks for the expenses related to producing, issuing, and retiring Federal Reserve notes. The assessment is allocated based on each Reserve Bank's share of the number of notes comprising the Federal Reserve Bank System's net liability for Federal Reserve notes on December 31 of the prior year. These expenses and assessments are reported separately from the Board's operating transactions in the Board's Statement of Revenues and Expenses and Changes in Cumulative Results of Operations.

Allowance for Doubtful Accounts — Accounts receivable are shown net of the allowance for doubtful accounts. Accounts receivable considered uncollectible are charged against the allowance account in the year they are deemed uncollectible. The allowance for doubtful accounts is adjusted monthly, based upon a review of outstanding receivables.

Property, Equipment, and Software — The Board's property, buildings, equipment, and software are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are calculated on a straight-line basis over the estimated useful lives of the assets, which range from three to ten years for furniture and equipment, ten to fifty years for building equipment and structures, and two to ten years for software. Upon the sale or other disposition of a depreciable asset, the cost and related accumulated depreciation or amortization are removed and any gain or loss is recognized.

The Board's internally developed software projects are each recorded at cost and capitalized and amortized over the project's useful life as required by the Internal Use Software Topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC).

Art Collections — The Board has collections of works of art, historical treasures, and similar assets. These collections are maintained and held for public exhibition in furtherance of public service. Proceeds from any sales of collections are used to acquire other items for collections. As permitted by the Revenue Recognition Topic of the ASC, the cost of collections purchased by the Board is charged to expense in the year purchased and donated collection items are not recorded. The value of the Board's collections has not been determined.

Deferred Rent — The leases contain scheduled rent increases over the term of the lease. As required by the Leases Topic of the ASC, rent abatements and scheduled rent increases must be considered in determining the annual rent expense to be recognized. The deferred rent represents the difference between the actual lease payments and the rent expense recognized.

Estimates — The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Recently Issued Accounting Standards — The Retirement Benefits Topic of the ASC provides rules for the disclosure of information about assets held in a defined benefit plan in the financial statements of the employer sponsoring that plan, and additional disclosures about asset categories and concentrations of risk. It is effective for financial statements with fiscal years ending after December 15, 2009. The provisions of the ASC have been reflected in the accompanying footnotes.

The Subsequent Events Topic of the ASC establishes general standards of accounting for and disclosure of events that occur through the balance sheet date but before financial statements are issued or are available to be issued. The ASC sets forth (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date, including disclosure of the date through which an entity has evaluated subsequent events and whether that represents the date the financial statements were issued or were available to be issued. The Board adopted the standard for the period ended December 31, 2009.

On June 30, 2009, the FASB issued SFAS No. 168, "The Statement of Financial Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles — a replacement of SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles" (SFAS 168). SFAS 168 establishes the FASB ASC as the source of authoritative accounting principles recognized by the FASB to be applied by entities in the preparation of financial statements in conformity with GAAP. The ASC does not change current GAAP, but it introduces a new structure that organizes the authoritative standards by topic. SFAS 168 is effective for financial statements issued for periods ending after September 15, 2009. In accordance with the requirements of this standard, the ASC is referenced in the Board's financial statements and footnotes.

(4) Property, Equipment, and Software

The following is a summary of the components of the Board's property, equipment, and software, at cost, net of accumulated depreciation and amortization as of December 31, 2009 and 2008:

	As of December 31,	
	2009	2008
Land	$ 18,640,314	$ 18,640,314
Buildings and improvements	155,403,350	150,602,767
Furniture and equipment	66,411,669	56,104,247
Software in use	16,196,241	14,514,315
Software in process	6,276,842	3,832,516
Construction in process	8,100,559	3,818,295
Total	271,028,975	247,512,454
Less accumulated depreciation and amortization	(111,761,370)	(98,636,964)
Property, equipment, and software — net	$ 159,267,605	$148,875,490

Construction in process includes costs incurred in 2009 and 2008 for long-term projects and building enhancements. The Board has accrued liabilities related to property, equipment, and software of $7,131,000 as of December 31, 2009.

The Board entered into capital leases for printing equipment during 2003 that terminated in May 2008. The Board subsequently entered into new capital leases in 2008 and 2009. Under the new commitments, the capital lease term extends through 2012. Furniture and equipment includes $2,086,000 and $1,923,000 in 2009 and 2008, respectively, for capitalized leases. Accumulated depreciation includes $789,000 and $280,000 for capitalized leases as of 2009 and 2008, respectively. The Board paid interest related to these capital leases in the amount of $36,000 and $26,000 as of December 31, 2009 and 2008, respectively. The Board has accrued liabilities related to capital leases of $148,000 as of December 31, 2009.

The Board has leased space in its buildings to other governmental agencies. The revenues collected from these leases are $2,037,000 and $2,034,000 in 2009 and 2008, respectively.

The future minimum lease payments required under the capital leases and the present value of the net minimum lease payments as of December 31, 2009, are as follows:

Years Ending December 31	Amount
2010	$ 978,315
2011	978,315
2012	421,925
Total minimum lease payments	2,378,555
Less amount representing maintenance	(1,026,701)
Net minimum lease payments	1,351,854
Less amount representing interest	(36,387)
Present value of net minimum lease payments	1,315,467
Less current maturities of capital lease payments	(533,110)
Long-term capital lease obligations	$ 782,357

(5) Accumulated Retirement Benefits

Substantially all of the Board's employees participate in the Retirement Plan for Employees of the Federal Reserve System (the System Plan). The System Plan provides retirement benefits only to employees of the Board, the Federal Reserve Banks, and the Office of Employee Benefits of the Federal Reserve System (OEB). The Federal Reserve Bank of New York (FRB NY), on behalf of the System, recognizes the net assets and costs associated with the System Plan in its financial statements. Costs associated with the System Plan are not redistributed to other participating employers.

Employees of the Board who became employed prior to 1984 are covered by a contributory defined benefits program under the System Plan. Employees of the Board who became employed after 1983 are covered by a non-contributory defined benefits program under the System Plan. Contributions to the System Plan are actuarially determined and funded by participating employers. In 2009, the System made $500 million in contributions to the System Plan; the contributions may be adjusted upon completion of the 2010 actuarial valuation. The Board was not assessed a contribution for 2009.

Effective January 1, 1996, Board employees covered under the System Plan are also covered under a Benefits Equalization Plan (BEP). Benefits paid under the BEP are limited to those benefits that cannot be paid from the System Plan due to limitations imposed by Sections 401(a)(17), 415(b) and 415(e) of the Internal Revenue Code of 1986. Activity for the BEP as of December 31, 2009 and 2008, is summarized in the following tables:

	As of December 31,	
	2009	2008
Change in projected benefit obligation:		
Benefit obligation — beginning of year	$4,591,374	$2,201,675
Service cost	712,515	589,094
Interest cost	307,501	213,714
Plan participants' contributions		
Actuarial (gain) loss	(175,635)	1,137,486
Gross benefits paid	(27,649)	(35,016)
Plan amendments	492,461	484,421
Benefit obligation — end of year	$5,900,567	$4,591,374
Accumulated benefit obligation — end of year	$1,245,465	$1,267,005

	As of December 31, 2009	2008
Weighted-average assumptions used to determine benefit obligation as of December 31:		
Discount rate	6.00%	6.00%
Rate of compensation increase	5.00%	5.00%
Change in plan assets:		
Fair value of plan assets — beginning of year	$ -	$ -
Employer contributions	27,649	35,016
Plan participants' contributions		
Gross benefits paid	(27,649)	(35,016)
Fair value of plan assets — end of year	$ -	$ -
Funded status:		
Reconciliation of funded status — end of year:		
Fair value of plan assets	$ -	$ -
Benefit obligations	5,900,567	4,591,374
Funded status	(5,900,567)	(4,591,374)
Amount recognized — end of year	$(5,900,567)	$(4,591,374)
Amounts recognized in the statements of financial position consist of:		
Asset	$ -	$ -
Liability	(5,900,567)	(4,591,374)
Net amount recognized	$(5,900,567)	$(4,591,374)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ 1,708,854	$ 2,031,269
Prior service cost (credit)	714,123	256,919
	$ 2,422,977	$ 2,288,188
Expected cash flow:		
Expected employer contributions — 2010	$ 111,143	
Expected benefit payments:*		
2010	$ 111,143	
2011	149,745	
2012	183,388	
2013	210,792	
2014	232,368	
2015–2019	1,421,730	

*Expected benefit payments to be made from System assets

	2009	2008
Components of net periodic benefit cost:		
Service cost	$ 712,515	$ 589,094
Interest cost	307,501	213,714
Expected return on plan assets	-	-
Amortization:		
Actuarial (gain) loss	146,780	112,474
Prior service (credit) cost	35,257	(5,902)
Net periodic benefit cost (credit)	$ 1,202,053	$ 909,380
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	6.00%	6.25%**
Rate of compensation increase	5.00%	5.00%

**In 2008, amendments to the System Plan were approved. As a result, the actuarially determined net periodic benefit expenses for the year ended December 31, 2008, were remeasured with a discount rate of 7.75% as of November 1, 2008.

	As of December 31,	
	2009	2008
*Other changes in plan assets and benefit obligations recognized in other comprehensive income:****		
Current year prior service (credit) cost	$ 492,461	$ 484,421
Current year actuarial (gain) loss	(175,635)	1,137,486
Amortization of prior service credit (cost)	(35,257)	5,902
Amortization of actuarial gain (loss)	(146,780)	(112,474)
Total recognized in other comprehensive income	$ 134,789	$1,515,335
Total recognized in net periodic benefit cost and other comprehensive income	$1,336,842	$2,424,715

***For the Benefit Equalization Plan, other changes to assets and benefits recognized in other comprehensive income will be reflected in net periodic cost.

Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2010 are shown below:

Net actuarial (gain) loss	$114,291
Prior service (credit) cost	12,290
Total	$126,581

On October 30, 2008, the Board approved a non-qualified plan for Officers of the Board. The retirement benefits covered under the Board Officer Pension Enhancement (BOPE), formerly the Supplemental Employee Retirement Plan (BSERP), increases the pension benefit calculation from 1.8% above the Social Security integration level to 2.0%. Activity for the BOPE as of December 31, 2009 and 2008, is summarized in the following tables:

	As of December 31,	
	2009	2008
Change in projected benefit obligation:		
Benefit obligation — beginning of year	$ 6,275,285	$ -
Service cost	333,034	37,190
Interest cost	402,680	56,010
Plan participants' contributions		
Actuarial (gain) loss	286,440	1,607,199
Gross benefits paid		
Plan amendments	(176,619)	4,574,886
Benefit obligation — end of year	$ 7,120,820	$ 6,275,285
Accumulated benefit obligation — end of year	$ 5,175,331	$ 4,530,540
Weighted-average assumptions used to determine benefit obligation as of December 31:		
Discount rate	6.00%	6.00%
Rate of compensation increase	5.00%	5.00%
Change in plan assets:		
Fair value of plan assets — beginning of year	$ -	$ -
Employer contributions		
Plan participants' contributions		
Gross benefits paid		
Fair value of plan assets — end of year	$ -	$ -
Funded status:		
Reconciliation of funded status — end of year:		
Fair value of plan assets	$ -	$ -
Benefit obligations	7,120,820	6,275,285
Funded status	(7,120,820)	(6,275,285)
Amount recognized — end of year	$(7,120,820)	$(6,275,285)

	As of December 31, 2009	As of December 31, 2008
Amounts recognized in the statements of financial position consist of:		
Asset	$ -	$ -
Liability	(7,120,820)	(6,275,285)
Net amount recognized	$(7,120,820)	$(6,275,285)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ 1,742,746	$ 1,607,199
Prior service cost (credit)	3,774,673	4,482,687
	$ 5,517,419	$ 6,089,886
Expected cash flows:		
Expected employer contributions — 2010	$ 41,829	
Expected benefit payments:****		
2010	$ 41,829	
2011	75,298	
2012	115,587	
2013	161,773	
2014	215,737	
2015–2019	1,967,583	

****Expected benefit payments to be made from System assets

	2009	2008
Components of net periodic benefit cost:		
Service cost	$ 333,034	$ 37,190
Interest cost	402,680	56,010
Expected return on plan assets		
Amortization:		
Actuarial (gain) loss	150,893	
Prior service (credit) cost	531,395	92,199
Net periodic benefit cost (credit)	$ 1,418,002	$ 185,399
Weighted-average assumptions used to determine net periodic benefit cost:		
Discount rate	6.00%	7.75%
Rate of compensation increase	5.00%	5.00%
*Other changes in plan assets and benefit obligations recognized in other comprehensive income:******		
Current year prior service (credit) cost	$ (176,619)	$ 4,574,886
Current year actuarial (gain) loss	286,440	1,607,199
Amortization of prior service credit (cost)	(531,395)	(92,199)
Amortization of actuarial gain (loss)	(150,893)	
Total recognized in other comprehensive income	$ (572,467)	$ 6,089,886
Total recognized in net periodic benefit cost and other comprehensive income	$ 845,535	$ 6,275,285

*****For the Board Officer Pension Enhancement, other changes in assets and benefits recognized in other comprehensive income will be reflected in net periodic cost.

Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2010 are shown below:

Net actuarial (gain) loss	$123,908
Prior service (credit) cost	531,395
Total	$655,303

The total accumulated retirement benefit obligation for both the Benefits Equalization Plan (BEP) and Board Officer Pension Enhancement (BOPE) as of December 31, 2009 and 2008, are as follows:

	As of December 31,	
	2009	2008
Accumulated retirement benefit obligation:		
Benefit obligation — BEP	$ 5,900,567	$ 4,591,374
Benefit obligation — BOPE	7,120,820	6,275,285
Total accumulated retirement benefit obligation	$13,021,387	$10,866,659

A relatively small number of Board employees participate in the Civil Service Retirement System (CSRS) of the Federal Employees' Retirement System (FERS). These defined benefit plans are administered by the U.S. Office of Personnel Management, which determines the required employer contribution levels. The Board's contributions to these plans totaled $329,000 and $305,000 in 2009 and 2008, respectively. The Board has no liability for future payments to retirees under these programs and is not accountable for the assets of the plans.

Employees of the Board may also participate in the Federal Reserve System's Thrift Plan or Roth 401(k). Board contributions to members' accounts were $14,342,000 and $11,815,000 in 2009 and 2008, respectively.

(6) Accumulated Postretirement Benefits

The Board provides certain life insurance programs for its active employees and retirees. Activity as of December 31, 2009 and 2008, is summarized in the following tables:

	As of December 31,	
	2009	2008
Change in projected benefit obligation:		
Benefit obligation — beginning of year	$ 8,527,800	$ 7,972,469
Service cost	169,687	176,450
Interest cost	516,194	505,691
Plan participants' contributions		
Actuarial (gain) loss	361,009	439,003
Gross benefits paid	(270,366)	(315,611)
Curtailments		(250,202)
Benefit obligation — end of year	$ 9,304,324	$ 8,527,800
Weighted-average assumptions used to determine benefit obligation as of December 31 — discount rate	5.75%	6.00%
Change in plan assets:		
Fair value of plan assets — beginning of year	$ -	$ -
Employer contributions	270,366	315,611
Gross benefits paid	(270,366)	(315,611)
Fair value of plan assets — end of year	$ -	$ -
Funded status:		
Reconciliation of funded status — end of year:		
Fair value of plan assets	$ -	$ -
Benefit obligations	9,304,324	8,527,800
Funded status	(9,304,324)	(8,527,800)
Amount recognized — end of year	$(9,304,324)	$(8,527,800)
Amounts recognized in the statements of financial position consist of:		
Asset	$ -	$ -
Liability	(9,304,324)	(8,527,800)
Net amount recognized	$(9,304,324)	$(8,527,800)
Amounts recognized in accumulated other comprehensive income consist of:		
Net actuarial loss (gain)	$ 1,528,733	$ 1,223,601
Prior service cost (credit)	(302,024)	(327,513)
	$ 1,226,709	$ 896,088

	As of December 31, 2009	As of December 31, 2008
Expected cash flows:		
Expected employer contributions — 2010	$ 342,502	$ 321,938
Expected benefit payments:*		
2010	$ 342,502	
2011	361,970	
2012	381,110	
2013	408,919	
2014	436,116	
2015–2019	2,570,408	

*Expected benefit payments to be made from System assets

	2009	2008
Components of net periodic benefit cost:		
Service cost	$ 169,687	$ 176,450
Interest cost	516,194	505,691
Expected return on plan assets		
Amortization:		
Actuarial (gain) loss	55,878	19,104
Prior service (credit) cost	(25,490)	(12,430)
Net periodic benefit cost (credit)	$ 716,269	$ 688,815
Weighted-average assumptions used to determine net periodic benefit cost — discount rate	6.00%	6.25%**

**In 2008, amendments to the Plan were approved. As a result, the actuarially determined net periodic benefit expenses for the year ended December 31, 2008, were remeasured with a discount rate of 7.75% as of November 1, 2008.

	2009	2008
Other changes in plan assets and benefit obligations recognized in other comprehensive income:		
Current year actuarial (gain) loss	$ 361,009	$ 439,003
Amortization of prior service credit (cost)	25,490	12,430
Amortization of actuarial gain (loss)	(55,878)	(19,104)
Curtailment effects — prior service (credit) cost		(250,202)
Total recognized in other comprehensive income	$ 330,621	$ 182,127
Total recognized in net periodic benefit cost and other comprehensive income	$1,046,890	$ 870,942

Estimated amounts that will be amortized from accumulated other comprehensive income into net periodic benefit cost (credit) in 2010 are shown below:

Net actuarial (gain) loss	$76,193
Prior service (credit) cost	(25,490)
Total	$50,703

(7) Accumulated Postemployment Benefits

The Board provides certain postemployment benefits to eligible former or inactive employees and their dependents during the period subsequent to employment but prior to retirement. Postemployment costs were actuarially determined using a December 31 measurement date and discount rates of 4.00% and 2.50% as of December 31, 2009 and 2008, respectively. The accrued postemployment benefit costs recognized by the Board as of December 31, 2009 and 2008, were $1,754,000 and $5,974,000, respectively.

(8) Accumulated Other Comprehensive Income

A reconciliation of beginning and ending balances of accumulated other comprehensive income for the years ended December 31, 2009 and 2008, is as follows:

	Amount Related to Defined Benefit Retirement Plans	Amount Related to Postretirement Benefits Other Than Pensions	Total Accumulated Other Comprehensive Income (Loss)
Balance — January 1, 2008	$ 772,853	$ 713,961	$(1,486,814)
Change in funded status of benefit plans:			
Prior service (credit) cost arising during the year	5,059,307		(5,059,307)
Amortization of prior service credit (costs)	(86,297)	12,430	73,867
Amortization of net actuarial gain (loss)	(112,474)	(19,104)	131,578
Net actuarial (gain) loss arising during the year	2,744,685	439,003	(3,183,688)
Curtailment effects — prior service (credit) cost		(250,202)	250,202
Change in funded status of benefit plans — other comprehensive income (loss)	7,605,221	182,127	(7,787,348)
Balance — December 31, 2008	8,378,074	896,088	(9,274,162)
Change in funded status of benefit plans:			
Prior service (credit) cost arising during the year	315,842		(315,842)
Amortization of prior service credit (costs)	(566,652)	25,490	541,162
Amortization of net actuarial gain (loss)	(297,673)	(55,878)	353,551
Net actuarial (gain) loss arising during the year	110,805	361,009	(471,814)
Change in funded status of benefit plans — other comprehensive income (loss)	(437,678)	330,621	107,057
Balance — December 31, 2009	$7,940,396	$1,226,709	$(9,167,105)

Additional detail regarding the classification of accumulated other comprehensive income is included in Notes 5 and 6.

(9) Federal Reserve Banks

The Board performs certain functions for the Reserve Banks in conjunction with its responsibilities for the System, and the Reserve Banks provide certain administrative functions for the Board. Activity related to the Board and Reserve Banks as of December 31, 2009 and 2008, is summarized in the following table:

	As of December 31, 2009	As of December 31, 2008
Reserve Bank expenses charged to the Board:		
Data processing and communication	$ 776,835	$ 2,368,144
Contingency site	1,171,808	1,265,618
Total Reserve Bank expenses charged to the Board	$ 1,948,643	$ 3,633,762
Board expenses charged to the Reserve Banks:		
Assessments for currency costs:		
Printing	$479,255,288	$477,927,083
Shipping	15,367,546	14,984,564
Retirement	3,608,937	3,722,146
Research and development	3,913,112	3,723,101
Assessments for operating expenses of the Board	386,399,900	352,290,700
Data processing	635,235	601,957
Total Board expenses charged to the Reserve Banks	$889,180,018	$853,249,551
Accounts receivable due from the Reserve Banks	$ 1,071,932	$ 1,016,688
Accounts payable due to the Reserve Banks		295,848

The Board contracted for audit services on behalf of entities that are included in the combined financial statements of the Federal Reserve Banks. The entities reimburse the Board for the cost of the audit services. The Board accrued liabilities of $138,000 and $313,000 in audit services and recorded receivables of $138,000 and $313,000 from the entities as of December 31, 2009 and 2008, respectively.

(10) Federal Financial Institutions Examination Council

The Board is one of the five member agencies of the Federal Financial Institutions Examination Council (the Council), and currently performs certain management functions for the Council. The five agencies that are represented on the Council are the Board, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision. The Board's financial statements do not include financial data for the Council. Activity related to the Board and Council, as of December 31, 2009 and 2008, is summarized in the following table:

	As of December 31,	
	2009	2008
Council expenses charged to the Board:		
Assessments for operating expenses	$ 67,998	$ 164,889
Central Data Repository	1,522,597	1,352,390
Uniform Bank Performance Report	210,293	185,833
Total Council expenses charged to the Board	$1,800,888	$1,703,112
Board expenses charged to the Council:		
Data processing related services	$4,884,868	$4,683,363
Administrative services	245,000	190,400
Total Board expenses charged to the Council	$5,129,868	$4,873,763
Accounts receivable due from the Council	$ 618,861	$ 650,672
Accounts payable due to the Council	209,922	373,466

(11) The Office of Employee Benefits of the Federal Reserve System

The Office of Employee Benefits of the Federal Reserve System (OEB) administers certain System benefit programs on behalf of the Board and the Reserve Banks, and costs associated with the OEB's activities are assessed to the Board and Reserve Banks. The Board was assessed $2,166,000 and $2,867,000 as of December 31, 2009 and 2008, respectively.

(12) Bureau of Engraving and Printing

The Bureau of Engraving and Printing (BEP) is the principal supplier for currency printing and retirement services. The currency costs incurred as of December 31, 2009 and 2008, are reflected in the following table:

	As of December 31,	
	2009	2008
Currency expenses charged to the Board:		
Printing	$479,255,288	$477,927,083
Retirement	3,608,937	3,722,146
Total currency expenses charged to the Board	$482,864,225	$481,649,229

(13) Commitments and Contingencies

Leases — The Board has entered into several operating leases to secure office, training and warehouse space. The Board has subleased space to other governmental agencies. The sublease agreements are annual and the revenue collected was $467,000 and $468,000 for 2009 and 2008, respectively.

Minimum annual payments under the operating leases having an initial or remaining non-cancelable lease term in excess of one year at December 31, 2009, are as follows:

Years Ending December 31	
2010	$ 6,297,594
2011	6,335,714
2012	6,414,807
2013	6,608,976
After 2013	42,414,511
	$68,071,602

Rental expenses under the operating leases were $3,947,000 and $2,207,000 for the years ended December 31, 2009 and 2008, respectively.

Deferred Leases — The change in deferred rent was $1,666,000 and $537,000 for the years ended December 31, 2009 and 2008, respectively.

Commitments — The Board has entered into an agreement with the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency, through the Council, to fund a portion of the enhancements and maintenance fees for a central data repository project through 2010 with an option to extend maintenance through 2013. The estimated Board expense to support this effort is $7.9 million for the base period and $2.6 million for the option period.

In 2007, the Council began a rewrite of the Home Mortgage Disclosure Act processing system, for which the Board provides data processing services. The estimated total expense to the Council of the rewrite is $3.2 million through 2010. The estimated total Board expense to support this effort with the maintenance extension option is $533,000.

Accrued liabilities include a federal tax liability estimated at $494,000 for the Board and its employees. The Board expects to pay the liability during 2010.

Litigation and Contingent Liabilities — The Board is subject to contingent liabilities which arise from litigation cases and various business contracts. These contingent liabilities arise in the normal course of operations and their ultimate disposition is unknown. Based on information currently available to management, it is management's opinion that the expected outcome of these matters, individually or in the aggregate, will not have a materially adverse effect on the financial statements.

One case alleges employment discrimination under Title VII of the Civil Rights Act of 1964, as amended, and the Age Discrimination in Employment Act, and is pending in the United States District Court for the District of Columbia. The second case is an action alleging discrimination on behalf of a class of African American secretaries at the Board. The case was dismissed by the United States District Court for the District of Columbia on January 31, 2007, and the plaintiffs' motion to alter or amend judgment was denied by that court on March 2, 2009. The plaintiffs have appealed the dismissal to the United States Court of Appeals for the District of Columbia circuit. The Board has substantial defenses for both cases and intends to defend the matters vigorously. Management believes that the likelihood of an adverse judgment for both cases is small.

The estimated contingent liabilities related to business contracts were $0 and $69,720 as of December 31, 2009 and 2008, respectively.

(14) Subsequent Events

There were no subsequent events that require adjustments to or disclosures in the financial statements as of December 31, 2009. Subsequent events were evaluated through March 19, 2010, which is the date the Board issued the financial statements.

Deloitte.

INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Governors of the Federal Reserve System:

We have audited the financial statements of the Board of Governors of the Federal Reserve System (the "Board") as of and for the year ended December 31, 2009, and have issued our report thereon dated March 19, 2010. We conducted our audit in accordance generally accepted auditing standards as established by the Auditing Standards Board (United States), auditing standards of the Public Company Accounting Oversight Board (United States), and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In accordance with standards of the Public Company Accounting Oversight Board (United States) and *Government Auditing Standards,* we have also issued our report dated March 19, 2010, on our tests of the Board's internal control over financial reporting. The purpose of that report is to describe the scope and the results of that testing. That report is an integral part of an audit performed in accordance with standards of the Public Company Accounting Oversight Board (United States) and *Government Auditing Standards* and should be considered in assessing the results of our audit.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Board's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

Distribution

This report is intended solely for the information and use of the Board, management, and others within the organization, Office of Inspector General, the United States Congress, and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte + Touche LLP

McLean, VA
March 19, 2010

Federal Reserve Banks Combined Financial Statements

The combined financial statements of the Federal Reserve Banks were audited by Deloitte & Touche LLP, independent auditors, for the years ended December 31, 2009 and 2008.

Deloitte.

INDEPENDENT AUDITORS' REPORT

To the Board of Governors of the Federal Reserve System
and the Board of Directors of the Federal Reserve Banks:

We have audited the accompanying combined statements of condition of the Federal Reserve Banks (the "Reserve Banks") as of December 31, 2009 and 2008, and the related combined statements of income and comprehensive income and changes in capital for the years then ended, which have been prepared in conformity with accounting principles established by the Board of Governors of the Federal Reserve System. These combined financial statements are the responsibility of the Division of Reserve Bank Operations and Payment System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Reserve Banks are not required to have, nor were we engaged to perform, an audit of their internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Reserve Bank's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 4 to the combined financial statements, the Reserve Banks have prepared these combined financial statements in conformity with accounting principles established by the Board of Governors of the Federal Reserve System, as set forth in the Financial Accounting Manual for Federal Reserve Banks, which is a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The effects on such combined financial statements of the differences between the accounting principles established by the Board of Governors of the Federal Reserve System and accounting principles generally accepted in the United States of America are also described in Note 4.

In our opinion, such combined financial statements present fairly, in all material respects, the combined financial position of the Reserve Banks as of December 31, 2009 and 2008, and the combined results of their operations for the years then ended, on the basis of accounting described in Note 4.

Deloitte & Touche LLP

April 21, 2010

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CONDITION
(in millions)

	As of December 31, 2009	As of December 31, 2008
Assets		
Gold certificates	$ 11,037	$ 11,037
Special drawing rights certificates	5,200	2,200
Coin	2,053	1,688
Items in process of collection	507	979
Prepaid interest on Federal Reserve notes	-	2,425
Loans to depository institutions	96,618	544,010
Other loans, net (of which $48,183 million is measured at fair value as of December 31, 2009)	69,433	100,082
System Open Market Account:		
Securities purchased under agreements to resell	-	80,000
Treasury securities, net	805,972	481,449
Government-sponsored enterprise debt securities, net	167,362	20,740
Federal agency and government-sponsored enterprise mortgage-backed securities, net	918,927	-
Investments denominated in foreign currencies	25,272	24,804
Central bank liquidity swaps	10,272	553,728
Other investments	5	-
Consolidated variable interest entities:		
Investments held by consolidated variable interest entities (of which $71,648 million and $74,570 million is measured at fair value as of December 31, 2009 and 2008, respectively)	81,380	411,996
Preferred securities	25,106	-
Accrued interest receivable	12,641	7,389
Bank premises and equipment, net	2,624	2,572
Other assets	638	629
Total assets	$2,235,047	$2,245,728
Liabilities and Capital		
Federal Reserve notes outstanding, net	$ 887,846	$ 853,168
System Open Market Account:		
Securities sold under agreements to repurchase	77,732	88,352
Other liabilities	601	-
Consolidated variable interest entities:		
Beneficial interest in consolidated variable interest entities	5,095	2,824
Other liabilities (of which $143 million is measured at fair value as of December 31, 2009)	1,316	5,813
Deposits:		
Depository institutions	976,988	860,000
Treasury, general account	186,632	106,123
Treasury, supplementary financing account	5,001	259,325
Other deposits	36,228	21,671
Deferred credit items	2,103	2,471
Accrued interest on Federal Reserve notes	1,191	-
Interest due to depository institutions	113	88
Accrued benefit costs	2,631	3,374
Other liabilities	290	367
Total liabilities	2,183,767	2,203,576
Capital paid-in	25,640	21,076
Surplus (including accumulated other comprehensive loss of $3,676 million and $4,683 million at December 31, 2009 and 2008, respectively)	25,640	21,076
Total capital	51,280	42,152
Total liabilities and capital	$2,235,047	$2,245,728

The accompanying notes are an integral part of these combined financial statements.

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(in millions)

	For the years ended December 31, 2009	2008
Interest income:		
Loans to depository institutions	$ 990	$ 3,817
Other loans, net	4,519	3,348
System Open Market Account:		
Securities purchased under agreements to resell	13	1,891
Treasury securities	22,873	25,532
Government-sponsored enterprise debt securities	2,048	99
Federal agency and government-sponsored enterprise mortgage-backed securities	20,407	-
Investments denominated in foreign currencies	296	623
Central bank liquidity swaps	2,168	3,606
Other investments	1	-
Investments held by consolidated variable interest entities	9,820	4,087
Total interest income	63,135	43,003
Interest expense:		
System Open Market Account:		
Securities sold under agreements to repurchase	98	737
Depository institution deposits	2,183	817
Beneficial interest in consolidated variable interest entities	267	463
Total interest expense	2,548	2,017
Provision for loan restructuring	(2,621)	-
Net interest income, after provision for loan restructuring	57,966	40,986
Non-interest income (loss):		
Other loans unrealized gains	557	-
System Open Market Account:		
Treasury securities gains	-	3,769
Federal agency and government-sponsored enterprise mortgage-backed securities gains, net	879	-
Foreign currency gains, net	172	1,266
Consolidated variable interest entities:		
Investments held by consolidated variable interest entities losses, net	(1,937)	(9,626)
Beneficial interest in consolidated variable interest entities (losses) gains, net	(1,903)	4,389
Dividends on preferred securities	106	-
Income from services	663	773
Reimbursable services to government agencies	450	461
Other income	443	899
Total non-interest (loss) income	(570)	1,931
Operating expenses:		
Salaries and other benefits	2,802	2,184
Occupancy expense	280	275
Equipment expense	183	200
Assessments by the Board of Governors	888	853
Professional fees related to consolidated variable interest entities	125	80
Other expenses	702	662
Total operating expenses	4,980	4,254
Net income prior to distribution	52,416	38,663
Change in funded status of benefit plans	1,007	(3,159)
Comprehensive income prior to distribution	$53,423	$35,504
Distribution of comprehensive income:		
Dividends paid to member banks	$ 1,428	$ 1,189
Transferred to surplus and change in accumulated other comprehensive income (loss)	4,564	2,626
Payments to Treasury as interest on Federal Reserve notes	47,431	31,689
Total distribution	$53,423	$35,504

The accompanying notes are an integral part of these combined financial statements.

FEDERAL RESERVE BANKS
COMBINED STATEMENTS OF CHANGES IN CAPITAL
for the years ended December 31, 2009 and December 31, 2008

(in millions, except share data)

		Surplus			
	Capital Paid-In	Net Income Retained	Accumulated Other Comprehensive (Loss) Income	Total Surplus	Total Capital
Balance at January 1, 2008 (368,996,413 shares)	$18,450	$19,974	$(1,524)	$18,450	$36,900
Net change in capital stock issued (52,521,054 shares)	2,626	-	-	-	2,626
Transferred to surplus and change in accumulated other comprehensive income (loss)	-	5,785	(3,159)	2,626	2,626
Balance at December 31, 2008 (421,517,467 shares)	$21,076	$25,759	$(4,683)	$21,076	$42,152
Net change in capital stock issued (91,289,192 shares)	4,564	-	-	-	4,564
Transferred to (from) surplus and change in accumulated other comprehensive income	-	3,557	1,007	4,564	4,564
Balance at December 31, 2009 (512,806,659 shares)	$25,640	$29,316	$(3,676)	$25,640	$51,280

The accompanying notes are an integral part of these combined financial statements.

Notes to the Combined Financial Statements of the Federal Reserve Banks

(1) Structure

The 12 Federal Reserve Banks ("Reserve Banks") are part of the Federal Reserve System ("System") created by Congress under the Federal Reserve Act of 1913 ("Federal Reserve Act"), which established the central bank of the United States. The Reserve Banks are chartered by the federal government and possess a unique set of governmental, corporate, and central bank characteristics.

In accordance with the Federal Reserve Act, supervision and control of each Reserve Bank is exercised by a board of directors. The Federal Reserve Act specifies the composition of the board of directors for each of the Reserve Banks. Each board is composed of nine members serving three-year terms: three directors, including those designated as chairman and deputy chairman, are appointed by the Board of Governors of the Federal Reserve System ("Board of Governors") to represent the public, and six directors are elected by member banks. Banks that are members of the System include all national banks and any state-chartered banks that apply and are approved for membership. Member banks are divided into three classes according to size. Member banks in each class elect one director representing member banks and one representing the public. In any election of directors, each member bank receives one vote, regardless of the number of shares of Reserve Bank stock it holds.

In addition to the 12 Reserve Banks, the System also consists, in part, of the Board of Governors and the Federal Open Market Committee ("FOMC"). The Board of Governors, an independent federal agency, is charged by the Federal Reserve Act with a number of specific duties, including general supervision over the Reserve Banks. The FOMC is composed of members of the Board of Governors, the president of the Federal Reserve Bank of New York ("FRBNY"), and, on a rotating basis, four other Reserve Bank presidents.

(2) Operations and Services

The Reserve Banks perform a variety of services and operations. These functions include participating in formulating and conducting monetary policy; participating in the payments system, including large-dollar transfers of funds, automated clearinghouse ("ACH") operations, and check collection; distributing coin and currency; performing fiscal agency functions for the U.S. Department of the Treasury ("Treasury"), certain federal agencies, and other entities; serving as the federal government's bank; providing short-term loans to depository institutions; providing loans to individuals, partnerships, and corporations in unusual and exigent circumstances; serving consumers and communities by providing educational materials and information regarding financial consumer protection rights and laws and information on community development programs and activities; and supervising bank holding companies, state member banks, and U.S. offices of foreign banking organizations. Certain services are provided to foreign and international monetary authorities, primarily by the FRBNY.

The FOMC, in conducting monetary policy, establishes policy regarding domestic open market operations, oversees these operations, and annually issues authorizations and directives to the FRBNY to execute transactions. The FOMC authorizes and directs the FRBNY to conduct operations in domestic markets, including the direct purchase and sale of Treasury securities, federal agency and government-sponsored enterprise ("GSE") debt securities, federal agency and GSE mortgage-backed securities ("MBS"), the purchase of these securities under agreements to resell, and the sale of these securities under agreements to repurchase. The FRBNY executes these transactions at the direction of the FOMC and holds the resulting securities and agreements in a portfolio known as the System Open Market Account ("SOMA"). The FRBNY is authorized to lend the Treasury securities and federal agency and GSE debt securities that are held in the SOMA.

In addition to authorizing and directing operations in the domestic securities market, the FOMC authorizes the FRBNY to execute operations in foreign markets in order to counter disorderly conditions in exchange markets or to meet other needs specified by the FOMC to carry out the System's central bank responsibilities. Specifically, the FOMC authorizes and directs the FRBNY to hold balances of, and to execute spot and forward foreign exchange and securities contracts for, 14 foreign currencies and to invest such foreign currency holdings, while maintaining adequate liquidity. The FRBNY is authorized and directed by the FOMC to maintain reciprocal currency arrangements with two central banks and to "warehouse" foreign currencies for the Treasury and the Exchange Stabilization Fund ("ESF"). The FRBNY is also authorized and directed by the FOMC to maintain U.S. dollar currency liquidity swap arrangements with 14 central banks. The FOMC has also authorized the FRBNY to maintain foreign currency liquidity swap arrangements with four foreign central banks.

Although the Reserve Banks are separate legal entities, they collaborate in the delivery of certain services to achieve greater efficiency and effectiveness. This collaboration takes the form of centralized operations and product or function offices that have responsibility for the delivery of certain services on behalf of the Reserve Banks. Various operational and management models are used and are supported by service agreements between the Reserve Banks. In some cases, costs incurred by a Reserve Bank for services provided to other Reserve Banks are not shared; in other cases, the Reserve Banks are reimbursed for costs incurred in providing services to other Reserve Banks.

(3) Financial Stability Activities

The Reserve Banks have implemented the following programs that support the liquidity of financial institutions and foster improved conditions in financial markets.

Expanded Open Market Operations and Support for Mortgage Related-Securities

The Single-Tranche Open Market Operation Program allows primary dealers to initiate a series of 28-day term repurchase transactions while pledging Treasury securities, federal agency and GSE debt securities, and federal agency and GSE MBS as collateral.

The Federal Agency and GSE Debt Securities and MBS Purchase Program provides support to the mortgage and housing markets and fosters improved conditions in financial markets. Under this program, the FRBNY purchases housing-related GSE debt securities and federal agency and GSE MBS. Purchases of housing-related GSE debt securities began in November 2008 and purchases of federal agency and GSE MBS began in January 2009. The FRBNY is authorized to purchase up to $200 billion in fixed rate, non-callable GSE debt securities and up to $1.25 trillion in fixed rate federal agency and GSE MBS. The activities of both of these programs are allocated to the other Reserve Banks.

Central Bank Liquidity Swaps

The FOMC authorized and directed the FRBNY to establish central bank liquidity swap arrangements, which may be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements.

U.S. dollar liquidity swap arrangements were authorized with 14 foreign central banks to provide liquidity in U.S. dollars to overseas markets. Such arrangements were authorized with 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 Japan, the Bank of Korea, the Banco de Mexico, the Reserve Bank of New Zealand, Norges Bank, the Monetary Authority of Singapore, the Sveriges Riksbank, and the Swiss National Bank. The maximum amount that could be drawn under these swap arrangements varied by central bank. The authorization for these swap arrangements expired on February 1, 2010.

Foreign currency liquidity swap arrangements provided the Reserve Banks with the capacity to offer foreign currency liquidity to U.S. depository institutions. Such arrangements were authorized with the Bank of England, the European Central Bank, the Bank of Japan, and the Swiss National Bank. The maximum amount that could be drawn under the swap arrangements varied by central bank. The authorization for these swap arrangements expired on February 1, 2010.

Lending to Depository Institutions

The Term Auction Facility ("TAF") promotes the efficient dissemination of liquidity by providing term funds to depository institutions. Under the TAF, Reserve Banks auction term funds to depository institutions against any collateral eligible to secure primary, secondary, and seasonal credit less a margin, which is a reduction in the assigned collateral value that is intended to provide the Reserve Banks additional credit protection. All depository institutions that are considered to be in generally sound financial condition by their Reserve Bank and that are eligible to borrow under the primary credit program are eligible to participate in TAF auctions. All loans must be collateralized to the satisfaction of the Reserve Banks.

Lending to Primary Dealers

The Term Securities Lending Facility ("TSLF") promoted liquidity in the financing markets for Treasury securities. Under the TSLF, the FRBNY could lend up to an aggregate amount of $200 billion of Treasury securities held in the SOMA to primary dealers secured for a term of 28 days. Securities were lent to primary dealers through a competitive single-price auction and were collateralized, less a margin, by a pledge of other securities, including Treasury securities, municipal securities, federal agency and GSE MBS, non-agency AAA/Aaa-rated private-label residential MBS, and asset-backed securities ("ABS"). The authorization for the TSLF expired on February 1, 2010.

The Term Securities Lending Facility Options Program ("TOP") offered primary dealers, through a competitive single-price auction, to purchase an option to draw upon short-term, fixed-rate TSLF loans in exchange for eligible collateral. The program enhanced the effectiveness of the TSLF by ensuring additional liquidity during periods of heightened collateral market pressures, such as around quarter-end dates. The program was suspended effective with the maturity of the June 2009 TOP options and the program authorization expired on February 1, 2010.

The Primary Dealer Credit Facility ("PDCF") was designed to improve the ability of primary dealers to provide financing to participants in the securitization markets. Primary dealers could obtain secured overnight financing under the PDCF in the form of repurchase transactions. Eligible collateral was that which could be pledged in tri-party arrangements, which primarily includes Treasury securities, federal agency and GSE MBS, other MBS, municipal securities, ABS, and money market equities. The interest rate charged on the secured financing was the Reserve Banks' primary credit rate. Participants paid a frequency-based fee if they accessed the program on more than 45 business days during the term of the program. Secured financing made under the PDCF was made with recourse to the primary dealer. The authorization for the PDCF expired on February 1, 2010.

The Transitional Credit Extension ("TCE") program provided liquidity support to broker-dealers that were in the process of transitioning to the bank holding company structure. Loans were collateralized similar to loans made under either the Reserve Banks' primary credit programs or the PDCF. The authorization for the TCE program expired on February 1, 2010.

Other Lending Facilities

The Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility ("AMLF") provided funding to depository institutions and bank holding companies to finance the purchase of eligible high-quality asset-backed commercial paper ("ABCP") from money market mutual funds. The program assisted money market mutual funds that hold such paper to meet the demands for investor redemptions and to foster liquidity in the ABCP market and money markets more generally. The Federal Reserve Bank of Boston ("FRBB") administered the AMLF and was authorized to extend these loans to eligible borrowers on behalf of the other Reserve Banks. All loans extended under the AMLF were non-recourse and were recorded as assets by the FRBB, and loans extended to borrowers that settle to depository accounts in other Districts were processed through the interdistrict settlement account. The credit risk related to the AMLF was assumed by the FRBB. The authorization for the AMLF expired on February 1, 2010.

The Commercial Paper Funding Facility ("CPFF program") enhanced the liquidity of the commercial paper market in the U.S. by increasing the availability of term commercial paper funding to issuers and by providing greater assurance to both issuers and investors that issuers would be able to roll over their maturing commercial paper. The authorization to purchase high-quality commercial paper through the CPFF program expired on February 1, 2010. The Commercial Paper Funding Facility LLC ("CPFF") is a Delaware limited liability company formed on October 14, 2008, in connection with the implementation of the CPFF program, to purchase eligible three-month unsecured commercial paper and ABCP directly from eligible issuers using the proceeds of loans made to CPFF by the FRBNY. CPFF is a single-member limited liability company, with the FRBNY as the sole and managing member. The FRBNY is the controlling party of CPFF and will remain as the controlling party as long as it retains an economic interest.

All lending to CPFF was made with recourse to the assets of CPFF. The interest rate on each loan to CPFF was the target federal funds rate and was fixed through the term of the loan. If the target federal funds rate was a range, the interest rate was set at the maximum rate within the range. Principal and accrued interest are payable to the FRBNY, in full, at the maturity date of the commercial paper. The FRBNY's loans to CPFF eliminate in consolidation.

To be eligible for purchase by CPFF, commercial paper was required to be (1) issued by a U.S. issuer (which includes U.S. issuers with a foreign parent company and U.S. branches of foreign banks) and (2) rated at least A-1/P-1/F1 by a nationally recognized statistical rating organization ("NRSRO") or, if rated by multiple NRSROs, was rated at least A-1/P-1/F1 by two or more. The commercial paper was also required to be U.S. dollar-denominated and have a three-month maturity. Commercial paper purchased by CPFF was discounted when purchased and carried at amortized cost. The maximum amount of a single issuer's commercial paper that CPFF could own at any time ("maximum face value limit") was the greatest amount of U.S. dollar-denominated commercial paper the issuer had outstanding on any day between January 1 and August 31, 2008. The CPFF did not purchase additional commercial paper from an issuer whose total commercial paper outstanding to all investors (including CPFF) equaled or exceeded the issuer's maximum face value limit.

Each issuer was required to pay a non-refundable facility fee upon registration with CPFF equal to 10 basis points of the issuer's maximum face value limit ("registration fee"). The CPFF program participants that issued unsecured commercial paper to CPFF were required to pay a surcharge of 100 basis points per annum of the face value ("credit enhancement fee"). The CPFF was authorized to reinvest cash in short-term and highly-liquid assets, which included Treasury securities, federal agency debt securities (excluding MBS), money market funds, repurchase agreements collateralized by Treasury securities and federal agency securities, and U.S. dollar-denominated overnight deposits. ABCP issuers that were inactive prior to the creation of the CPFF program were ineligible for participation. An issuer was considered inactive if it did not issue ABCP to institutions other than the sponsoring institution for any consecutive period of three months or longer between January 1 and August 31, 2008.

The Money Market Investor Funding Facility ("MMIFF") supported a private-sector initiative designed to provide liquidity to U.S. money market investors. Under the MMIFF, the FRBNY could provide senior secured funding to a series of special purpose vehicles ("SPV") to facilitate an industry-supported private-sector initiative to finance the purchase of eligible assets from eligible investors. No activity was recorded for the MMIFF in 2008 or 2009. The authorization for the MMIFF expired on October 30, 2009.

The Term Asset-Backed Securities Loan Facility ("TALF") assists financial markets in accommodating the credit needs of consumers and businesses of all sizes by facilitating the issuance of ABS collateralized by a variety of consumer and business loans; it is also intended to improve the market conditions for ABS. The Board of Governors has authorized the offering of TALF loans collateralized by newly issued ABS and legacy commercial mortgage-backed securities ("CMBS") until March 31, 2010 and TALF loans collateralized by newly issued CMBS until June 30, 2010.

Under the TALF, the FRBNY is authorized to lend up to $200 billion to eligible borrowers. Up to $100 billion of the total authorized TALF loans can have maturities of five years to finance purchases of CMBS, ABS backed by student loans, and ABS backed by loans guaranteed by the Small Business Administration ("SBA"). Interest proceeds paid on collateral supporting a five-year TALF loan or a three-year loan collateralized by CMBS may be used toward an accelerated repayment of the principal amount of the loan.

Each TALF loan is secured by eligible collateral, with the FRBNY lending an amount equal to the value of the collateral, as determined by the FRBNY, less a margin. Loan proceeds are disbursed to the borrower contingent on receipt by the FRBNY's custodian of the eligible collateral, an administrative fee, and, if applicable, a margin.

Eligible collateral includes U.S. dollar-denominated ABS that are (1) backed by student loans, auto loans, credit card loans, loans guaranteed by the SBA, loans or leases related to business equipment, leases of vehicle fleets, floor plan loans, mortgage servicing advances, and insurance premium finance loans that have a credit rating in the highest investment-grade rating category from two or more approved rating agencies and do not have a credit rating below the highest investment-grade rating category from a major rating agency, or (2) are newly issued CMBS or certain high-quality CMBS issued before January 1, 2009 ("legacy CMBS"). High-quality newly issued and legacy CMBS must have at least two AAA ratings from the approved ratings agencies and must not have a rating below AAA from any of these rating agencies. As of December 31, 2009, approved credit rating agencies for ABS included Fitch, Moody's Investors Service, and Standard & Poor's. The credit rating agencies for ABS were expanded in February 2010 to include DBRS and Realpoint. As of December 31, 2009, approved credit rating agencies for CMBS included Fitch, Moody's Investors Service, Standard & Poor's, DBRS, and Realpoint. Prior to its acceptance by the FRBNY, pledged collateral must also have met other risk assessment criteria as stipulated in the TALF program's terms and conditions.

The TALF loans are extended on a non-recourse basis. If the borrower does not repay the loan, the FRBNY will enforce its rights in the collateral and may sell the collateral to TALF LLC, a Delaware limited liability company, established for the purpose of purchasing such assets. As of December 31, 2009, the FRBNY had not enforced its rights to any of the collateral and, as a result, TALF LLC did not purchase such assets.

Pursuant to a put agreement with the FRBNY, TALF LLC has committed to purchase assets that secured a TALF loan at a price equal to the principal amount outstanding plus accrued but unpaid interest, regardless of fair value of the collateral. TALF LLC's purchases of these securities are funded first through the fees received by TALF LLC from the FRBNY for this commitment and any interest earned on its investments. The fee represents the spread on the TALF loans, which is the TALF loan interest rate paid by the TALF borrower less the overnight indexed swap ("OIS") rate plus 25 basis points. In the event that such funding proves insufficient for the asset purchases that TALF LLC has committed to make under the put agreement, the Treasury, as a subordinated lender, has committed to lend up to $20 billion to TALF LLC at a rate of the one-month London Interbank Offered Rate ("LIBOR") plus 300 basis points. The FRBNY has agreed to lend up to $180 billion to TALF LLC in the form of senior debt at a rate of the one-month LIBOR plus 100 basis points. Both the senior, when funded, and subordinated loans to TALF LLC are secured by all of the assets of TALF LLC through a pledge to Bank of New York Mellon as the collateral agent. The FRBNY is the managing member and the controlling party of TALF LLC and will remain as the controlling party as long as it retains an interest. After TALF LLC has paid all operating expenses and principal due to the FRBNY, the remaining proceeds of the portfolio holdings will be distributed in the following order, principal due to Treasury, interest due to the FRBNY, and interest due to Treasury. Any residual cash flows will be shared between the FRBNY, which will receive 10 percent, and the Treasury, which will receive 90 percent as contingent interest.

Support for Specific Institutions

Bear Stearns Companies, Inc.

In connection with and to facilitate the merger of The Bear Stearns Companies, Inc. ("Bear Stearns") and JPMorgan Chase & Co. ("JPMC"), the FRBNY extended credit to Maiden Lane LLC ("ML") in June 2008. ML is a Delaware limited liability company formed by the FRBNY to acquire certain assets of Bear Stearns and to manage those assets over time, in order to maximize the potential for the repayment of the credit extended to ML and to minimize disruption to the financial markets. The assets acquired by ML were valued at $29.9 billion as of March 14, 2008, the date that the FRBNY committed to the transaction, and largely consisted of federal agency and GSE MBS, non-agency residential mortgage-backed securities ("non-agency RMBS"), commercial and residential mortgage loans, and derivatives. The FRBNY extended a senior loan of approximately $28.8 billion and JPMC extended a subordinated loan of $1.15 billion to finance the acquisition of the assets through a pledge to State Street as the collateral agent. The interest rate on the senior loan is the primary credit rate in effect from time to time. JPMC bears the first $1.15 billion of any losses associated with the portfolio through its subordinated loan. Residual gains, if any, will be allocated to the FRBNY. The interest rate on the JPMC subordinated loan is the primary credit rate plus 450 basis points. The loans are collateralized by all of the assets of ML. The FRBNY is the sole and managing member and the controlling party of ML and will remain as such as long as the FRBNY retains an economic interest in ML.

American International Group, Inc.

In September 2008, the Board of Governors authorized the FRBNY to lend to American International Group, Inc., ("AIG"). Initially, the FRBNY provided AIG with a line of credit collateralized by the pledge of a substantial portion of the assets of AIG. Under the provisions of the original agreement, the FRBNY was authorized to lend up to $85 billion to AIG for two years at the three-month LIBOR, with a floor of 350 basis points, plus 850 basis points. In addition, the FRBNY assessed AIG a one-time commitment fee of 200 basis points on the full amount of the commitment and a fee of 850 basis points per annum on the undrawn credit line. A condition of the credit agreement was that AIG would issue to a trust, for the sole benefit of the fiscal treasury, preferred shares convertible to approximately 78 percent of the issued and outstanding shares of the common stock of AIG. The AIG Credit Facility Trust ("Trust") was formed January 16, 2009, and the preferred shares were issued to the Trust on March 4, 2009. The Trust has three independent trustees who control the Trust's voting and consent rights. The FRBNY cannot exercise voting or consent rights. On October 8, 2008, the FRBNY began providing cash collateral to certain AIG insurance subsidiaries in connection with AIG's domestic securities lending program.

The FRBNY and the Treasury announced a restructuring of the government's financial support to AIG in November 2008. As part of the restructuring, the Treasury purchased $40 billion of newly issued AIG preferred shares under the Troubled Asset Relief Program ("TARP"). The TARP funds were used to pay down AIG's debt to the FRBNY. In addition, the terms of the original agreement were modified to reduce the line of credit to $60 billion; reduce the interest rate to the three-month LIBOR with a floor of 350 basis points, plus 300 basis points; reduce the fee on undrawn funds to 75 basis points; and extend the term of the agreement to five years. The other material terms of the funding were unchanged. These revised terms were more consistent with terms granted to other entities with similar credit risk.

Concurrent with the November 2008 restructuring of its financial support to AIG, the FRBNY established two limited liability companies ("LLCs"). The FRBNY extended credit to Maiden Lane II LLC ("ML II"), a Delaware limited liability company formed to purchase non-agency RMBS from the reinvestment pool of the securities lending portfolio of several regulated U.S. insurance subsidiaries of AIG. ML II borrowed $19.5 billion from the FRBNY and used the proceeds to purchase non-agency RMBS that had an approximate fair value of $20.8 billion as of October 31, 2008 from AIG's domestic insurance subsidiaries. The FRBNY is the sole and managing member and the controlling party of ML II and will remain as the controlling party as long as the FRBNY retains an economic interest in ML II. Net proceeds received by ML II will be applied to pay the FRBNY's senior loan plus interest at one-month LIBOR plus 100 basis points. As part of the agreement, the AIG subsidiaries also received from ML II a fixed deferred purchase price of up to $1.0 billion, plus interest on any such fixed deferred purchase price outstanding at one-month LIBOR plus 300 basis points, payable from the net proceeds received by ML II and only to the extent that the FRBNY's senior loan, including accrued and unpaid interest, has been paid in full. After ML II has paid the FRBNY's senior loan, including accrued and unpaid interest, and the fixed deferred purchase price in full, including accrued and unpaid interest, the FRBNY will be entitled to receive five-sixths of any additional net proceeds received by ML II as contingent interest on the senior loan and the AIG subsidiaries will be entitled to receive one-sixth of any net proceeds received by ML II as variable deferred purchase price. The FRBNY's loan and the fixed deferred purchase price of the AIG subsidiaries are collateralized by all of the assets of ML II through a pledge to Bank of New York Mellon as the collateral agent. As a result of the formation and commencement of operations of ML II, the FRBNY's lending in connection with AIG's securities lending program was terminated.

The FRBNY also extended credit to Maiden Lane III LLC ("ML III"), a Delaware limited liability company formed to purchase ABS collateralized debt obligations ("ABS CDOs") from certain third-party counterparties of AIG Financial Products Corp. ("AIGFP"). In connection with the acquisitions, the third-party counterparties agreed to terminate their related credit default swap ("CDS") contracts with AIGFP. ML III borrowed approximately $24.3 billion from the FRBNY and AIG provided an equity contribution of $5 billion to ML III. The proceeds were used to purchase ABS CDOs with a fair value of $29.6 billion. The counterparties received $26.8 billion net of principal, interest received, and finance charges paid. ML III also made a payment to AIGFP of $2.5 billion, representing the return of excess collateral previously posted by AIGFP with the counterparties. The FRBNY is the managing member and the controlling party of ML III and will remain as the controlling party as long as the FRBNY retains an economic interest in ML III. Net proceeds received by ML III will be applied to repay the FRBNY's senior loan plus interest at one-month LIBOR plus 100 basis points. The FRBNY's senior loan is collateralized by all of the assets of ML III through a pledge to Bank of New York Mellon as the collateral agent. After payment of principal and accrued and unpaid interest on the FRBNY's senior loan in full, AIG, or its assignee, is entitled to receive from ML III repayment of its equity contribution, including accrued and unpaid interest at one-month LIBOR plus 300 basis points, payable from net proceeds received by ML III as additional interest. After ML III has paid the FRBNY's senior loan and AIG's equity contribution in full, the FRBNY will be entitled to receive two-thirds of any additional net proceeds received by ML III on the senior loan and AIG, or its assignee, will be entitled to receive one-third of any net proceeds received by ML III as contingent distributions on its equity interest.

On April 17, 2009, the FRBNY, as part of the U.S. government's commitment to the orderly restructuring of AIG over time, in the face of continuing market dislocations, additionally restructured the AIG loan by lowering the interest rate. Effective April 17, 2009, the 350 basis-point floor on LIBOR used to calculate the interest rate on the loan was eliminated. The interest rate on the modified loan is the three-month LIBOR plus 300 basis points.

On December 1, 2009, the FRBNY's commitment to lend to AIG was reduced to $35 billion and the outstanding balance of the FRBNY's loan to AIG was reduced by $25 billion in exchange for a liquidation preference of nonvoting perpetual preferred interests in two limited liability companies. AIG created these limited liability companies to hold, directly or indirectly, all of the outstanding common stock of American Life Insurance Company ("ALICO") and American International Assurance Company Ltd. ("AIA"), two life insurance holding company subsidiaries of AIG. The FRBNY will be paid a 5 percent cumulative dividend on its nonvoting preferred interests through September 22, 2013 and a 9 percent cumulative dividend thereafter. Although the FRBNY has certain governance rights to protect its interests, AIG retains control of the limited liability companies and the underlying operating companies. The initial value of the FRBNY's preferred interests, which represents a percentage of the fair market value of ALICO and AIA at December 1, 2009, was $16 billion for the AIA Aurora LLC ("AIA LLC") and $9 billion for the ALICO Holdings LLC ("ALICO LLC").

In addition, the FRBNY was authorized to make loans of up to $8.5 billion to other SPVs established by AIG or its subsidiaries. Loans extended by the FRBNY to these SPVs would have been repaid from net cash flows of designated blocks of existing life insurance policies issued by certain domestic insurance subsidiaries of AIG. No loans were made under this authorization during the year ended December 31, 2009. On February 26, 2010, AIG stated in its 2009 annual report filed with the Securities and Exchange Commission that it was no longer pursuing this transaction.

Citigroup, Inc.

The Board of Governors, the Treasury, and the FDIC ("parties") jointly announced on November 23, 2008, that they would provide financial support to Citigroup, Inc. ("Citigroup"). The agreement provided funding support for possible future principal losses on up to $301 billion of Citigroup's assets. The funding support was for a period of ten years for residential assets and five years for non-residential assets. Under the agreement, a loss on a portfolio asset would have included a charge-off or realized loss upon collection, through a permitted disposition or exchange, or upon a foreclosure or short-sale loss, but not through a change in Citigroup's mark-to-market accounting for the asset or the creation or increase of a related loss reserve. The FRBNY's commitment to lend under the agreement would have been triggered at the time that qualifying losses of $56.2 billion were recognized in the covered assets pool. At that point, if Citigroup made a proper election, the FRBNY would have made a single non-recourse loan to Citigroup in an amount equal to the aggregate adjusted baseline value of the remaining covered assets, as defined in the relevant agreements. Under this agreement, no loans were made during the years ended December 31, 2009 and 2008. On December 23, 2009, the parties terminated the arrangement and, as consideration for terminating the agreement, Citigroup paid the FRBNY a $50 million termination fee and agreed to reimburse the FRBNY for its out-of-pocket expenses.

Bank of America Corporation

The parties jointly announced on January 15, 2009, that they would provide financial support to Bank of America Corporation ("Bank of America"). Under this arrangement, the Federal Reserve Bank of Richmond ("FRBR") would have provided funding support for possible future principal losses relating to a designated pool of up to $118 billion of financial instruments. The FRBR's commitment under the arrangement was to provide non-recourse loans to Bank of America if, and when, qualifying losses of $18 billion were recorded in the pool. On September 21, 2009, however, the parties announced that they had reached an agreement with Bank of America to terminate the agreement. As part of the termination of the agreement, Bank of America paid $57 million in compensation for out-of-pocket expenses incurred by the FRBR and an amount equal to the commitment fees required by the agreement.

(4) Significant Accounting Policies

Accounting principles for entities with the unique powers and responsibilities of a nation's central bank have not been formulated by accounting standard-setting bodies. The Board of Governors has developed specialized accounting principles and practices that it considers to be appropriate for the nature and function of a central bank. These accounting principles and practices are documented in the *Financial Accounting Manual for Federal Reserve Banks* ("Financial Accounting Manual" or "FAM"), which is issued by the Board of Governors. The Reserve Banks are required to adopt and apply accounting policies and practices that are consistent with the FAM and the combined financial statements have been prepared in accordance with the FAM.

Limited differences exist between the accounting principles and practices in the FAM and generally accepted accounting principles in the United States ("GAAP"), primarily due to the unique nature of the Reserve Banks' powers and responsibilities as the nation's central bank. The primary difference is the presentation of all SOMA securities holdings at amortized cost rather than the fair value presentation required by GAAP. Treasury securities, GSE debt securities, federal agency and GSE MBS, and investments denominated in foreign currencies comprising the SOMA are recorded at cost on a settlement-date basis rather than the trade-date basis required by GAAP. The cost basis of Treasury securities, GSE debt securities, and foreign government debt instruments is adjusted for amortization of premiums or accretion of discounts on a straight-line basis. Amortized cost more appropriately reflects the Reserve Banks' securities holdings given the System's unique responsibility to conduct monetary policy. Accounting for these securities on a settlement-date basis more appropriately reflects the timing of the transaction's effect on the quantity of reserves in the banking system. Although the application of fair-value measurements to the securities holdings may result in values substantially above or below their carrying values, these unrealized changes in value have no direct effect on the quantity of reserves available to the banking system or on the prospects for future Reserve Bank earnings or capital. Both the domestic and foreign components of the SOMA portfolio may involve transactions that result in gains or losses when holdings are sold prior to maturity. Decisions regarding securities and foreign currency transactions, including their purchase and sale, are motivated by monetary policy objectives rather than profit. Accordingly, fair values, earnings, and gains or losses resulting from the sale of such securities and currencies are incidental to the open market operations and do not motivate decisions related to policy or open market activities.

In addition, the Reserve Banks have elected not to present a Combined Statement of Cash Flows because the liquidity and cash position of the Reserve Banks are not a primary concern given the Reserve Banks' unique powers and responsibilities. Other information regarding the Reserve Banks' activities is provided in, or may be derived from, the Combined Statements of Condition, Income and Comprehensive Income, and Changes in Capital. There are no other significant differences between the policies outlined in the FAM and GAAP.

Preparing the combined financial statements in conformity with the FAM requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of income and expenses during the reporting period. Actual results could differ from those estimates. Certain amounts relating to the prior year have been reclassified to conform to the current-year presentation. The classification of certain variable interest entities ("VIE") assets have been reclassified as follows: RMBS and non agency CMOs have been reclassified as Non-agency RMBS and agency CMOs and TBA commitments have been reclassified as federal agency and GSE MBS. Unique accounts and significant accounting policies are explained below.

(a) Consolidation

The combined financial statements include the accounts and results of operations of the Reserve Banks as well as several VIEs, which include ML, ML II, ML III, CPFF, and TALF LLC. The consolidation of the VIEs was assessed in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification (ASC) Topic 810 (ASC 810), *Consolidation* (previously FIN 46R), which requires a variable interest entity to be consolidated by its controlling financial interest holder. Intercompany balances and transactions have been eliminated in consolidation.

A Reserve Bank consolidates a VIE if it has a controlling financial interest because it will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or it is most closely associated with the VIE. To determine whether it is the controlling financial interest holder of a VIE, the Reserve Bank evaluates the VIE's design, capital structure, and relationships with the variable interest holders. The Reserve Bank reconsiders whether it is the controlling financial interest holder of a VIE, as required by ASC 810, when certain events occur.

(b) Gold and Special Drawing Rights Certificates

The Secretary of the Treasury is authorized to issue gold and special drawing rights ("SDR") certificates to the Reserve Banks.

Payment for the gold certificates by the Reserve Banks is made by crediting equivalent amounts in dollars into the account established for the Treasury. The gold certificates held by the Reserve Banks are required to be backed by the gold of the Treasury. The Treasury may reacquire the gold certificates at any time and the Reserve Banks must deliver them to the Treasury. At such time, the Treasury's account is charged, and the Reserve Banks' gold certificate accounts are reduced. The value of gold for purposes of backing the gold certificates is set by law at $42 2/9 per fine troy ounce. The Board of Governors allocates the gold certificates among the Reserve Banks once a year based on the average Federal Reserve notes outstanding in each Reserve Bank.

SDR certificates are issued by the International Monetary Fund (the "Fund") to its members in proportion to each member's quota in the Fund at the time of issuance. SDR certificates serve as a supplement to international monetary reserves and may be transferred from one national monetary authority to another. Under the law providing for U.S. participation in the SDR system, the Secretary of the Treasury is authorized to issue SDR certificates to the Reserve Banks. When SDR certificates are issued to the Reserve Banks, equivalent amounts in U.S. dollars are credited to the account established for the Treasury and the Reserve Banks' SDR certificate accounts are increased. The Reserve Banks are required to purchase SDR certificates, at the direction of the Treasury, for the purpose of financing SDR acquisitions or for financing exchange stabilization operations. At the time SDR transactions occur, the Board of Governors allocates SDR certificate transactions among the Reserve Banks based upon each Reserve Bank's Federal Reserve notes outstanding at the end of the preceding year. There were no SDR transactions in 2008, and in 2009 the Treasury issued $3 billion in SDR certificates to the Reserve Banks.

(c) Loans to Depository Institutions and Other Loans

Loans, except for loans extended under TALF, are reported at their outstanding principal balances net of unamortized administrative or commitment fees, and interest income is recognized on an accrual basis. Loan administrative and commitment fees are generally deferred and amortized on a straight-line basis over the term of the loan or commitment period. This method results in an interest amount that is substantially similar to the interest method.

Loans are impaired when, based on current information and events, it is probable that the Reserve Banks will not receive the principal or interest that is due in accordance with the contractual terms of the loan agreement. Loans are evaluated to determine whether an allowance for loan loss is required. The Reserve Banks have developed procedures for assessing the adequacy of any allowance for loan losses using all available information to reflect the assessment of credit risk. This assessment includes monitoring information obtained from banking supervisors, borrowers, and other sources to assess the credit condition of the borrowers and, as appropriate, evaluating collateral values for each program. Generally, the Reserve Banks discontinue recognizing interest income on impaired loans until the borrower's repayment performance demonstrates principal and interest will be received in accordance with the term of the loan agreement. If a Reserve Bank discontinues recording interest on an impaired loan, cash payments are first applied to principal until the loan balance is reduced to zero; subsequent payments are applied as recoveries of amounts previously deemed uncollectible, if any, and then as interest income.

Impaired loans include loans that have been modified in debt restructurings involving borrowers experiencing financial difficulties. The allowance for loan restructuring is determined by discounting the restructured cash flows using the original effective rate for the loan. Similar to other impaired loans, the Reserve Banks discontinue recognizing interest income until the borrower demonstrates that it can meet the restructured terms. Performance prior to the restructuring, or significant events that coincide with the restructuring, are considered in assessing whether the borrower can meet the new terms and, if so, the Reserve Banks may resume recording interest income.

The FRBNY has elected to record the TALF loans at fair value in accordance with FASB ASC Topic 825 (ASC 825), *Fair Value Option* (previously SFAS 159). Unrealized gains (losses) on TALF loans that are recorded at fair value are reported as "Non-interest income (loss): Other loans unrealized gains" in the Combined Statements of Income and Comprehensive Income. The interest income on TALF loans is recognized based on the contracted rate and is reported as a component of "Interest Income: Other loans" in the Combined Statements of Income and Comprehensive Income. Administrative fees paid by borrowers at the initiation of each loan are recognized as incurred and not deferred, are reported as a component of "Non-interest income (loss): Other income" in the Combined Statements of Income and Comprehensive Income.

(d) Securities Purchased Under Agreements to Resell, Securities Sold Under Agreements to Repurchase, and Securities Lending

The FRBNY may engage in purchases of securities with primary dealers under agreements to resell ("repurchase transactions"). These repurchase transactions are typically executed through a tri-party arrangement ("tri-party transactions"). Tri-party transactions are conducted with two commercial custodial banks that manage the clearing, settlement, and pledging of collateral. The collateral pledged must exceed the principal amount of the transaction. Acceptable collateral under tri-party repurchase transactions primarily includes Treasury securities; pass-through mortgage securities of Fannie Mae, Freddie Mac, and Ginnie Mae; STRIP Treasury securities; and "stripped" securities of federal agencies. The tri-party transactions are accounted for as financing transactions with the associated interest income accrued over the life of the transaction. Repurchase transactions are reported at their contractual amount as "System Open Market Account: Securities purchased under agreements to resell" in the Combined Statements of Condition and the related accrued interest receivable is reported as a component of "Accrued interest receivable."

The FRBNY may engage in sales of securities with primary dealers under agreements to repurchase ("reverse repurchase transactions"). These reverse repurchase transactions may be executed through a tri-party arrangement, similar to repurchase transactions. Reverse repurchase transactions may also be executed with foreign official and international accounts. Reverse repurchase transactions are accounted for as financing transactions, and the associated interest expense is recognized over the life of the transaction. These transactions are reported at their contractual amounts in the Combined Statements of Condition and the related accrued interest payable is reported as a component of "Other liabilities."

Treasury securities and GSE debt securities held in the SOMA are lent to primary dealers to facilitate the effective functioning of the domestic securities market. Overnight securities lending transactions are fully collateralized by other Treasury securities. TSLF transactions are fully collateralized with investment-grade debt securities, collateral eligible for tri-party repurchase agreements arranged by the FRBNY, or both. The collateral taken in both overnight and term securities lending transactions is in excess of the fair value of the securities lent. The FRBNY charges the primary dealer a fee for borrowing securities, and these fees are reported as a component of "Other income." In addition, TOP fees are reported as a component of "Other income."

Activity related to securities purchased under agreements to resell, securities sold under agreements to repurchase, and securities lending is allocated to each of the Reserve Banks on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April each year.

The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District.

(e) Treasury Securities; Government-Sponsored Enterprise Debt Securities; Federal Agency and Government-Sponsored Enterprise Mortgage-Backed Securities; Investments Denominated in Foreign Currencies; and Warehousing Agreements

Interest income on Treasury securities, GSE debt securities, and investments denominated in foreign currencies comprising the SOMA is accrued on a straight-line basis. Interest income on federal agency and GSE MBS is accrued using the interest method and includes amortization of premiums, accretion of discounts, and paydown gains or losses. Paydown gains or losses result from scheduled payment and prepayment of principal and represent the difference between the principal amount and the carrying value of the related security. Gains and losses resulting from sales of securities are determined by specific issue based on average cost.

In addition to outright purchases of federal agency and GSE MBS that are held in the SOMA, the FRBNY enters into dollar roll transactions ("dollar rolls"), which primarily involve an initial transaction to purchase or sell "to be announced" ("TBA") MBS combined with an agreement to sell or purchase TBA MBS on a specified future date. The FRBNY's participation in the dollar roll market furthers the MBS Purchase Program goal of providing support to the mortgage and housing markets and fostering improved conditions in financial markets. The FRBNY accounts for outstanding commitments to sell or purchase TBA MBS on a settlement-date basis. Based on the terms of the FRBNY dollar roll transactions, transfers of MBS upon settlement of the initial TBA MBS transactions are accounted for as purchases or sales in accordance with FASB ASC Topic 860 (ASC 860), *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions,* (previously SFAS 140), and the related outstanding commitments are accounted for as sales or purchases upon settlement.

Activity related to Treasury securities, GSE debt securities, and federal agency and GSE MBS, including the premiums, discounts, and realized gains and losses, is allocated to each Reserve Bank on a percentage basis derived from an annual settlement of the interdistrict settlement account that occurs in April of each year. The settlement also equalizes Reserve Bank gold certificate holdings to Federal Reserve notes outstanding in each District. Activity related to investments denominated in foreign currencies, including the premiums, discounts, and realized and unrealized gains and losses, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

Foreign-currency-denominated assets are revalued daily at current foreign currency market exchange rates in order to report these assets in U.S. dollars. Realized and unrealized gains and losses on investments denominated in foreign currencies are reported as "Foreign currency gains or losses" in the Combined Statements of Income and Comprehensive Income.

Warehousing is an arrangement under which the FOMC agrees to exchange, at the request of the Treasury, U.S. dollars for foreign currencies held by the Treasury or ESF over a limited period of time. The purpose of the warehousing facility is to supplement the U.S. dollar resources of the Treasury and ESF for financing purchases of foreign currencies and related international operations.

Warehousing agreements are designated as held-for-trading purposes and are valued daily at current market exchange rates. Activity related to these agreements is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31.

(f) Central Bank Liquidity Swaps

Central bank liquidity swaps, which are transacted between the FRBNY and a foreign central bank, may be structured as either U.S. dollar liquidity or foreign currency liquidity swap arrangements.

Activity related to U.S. dollar and foreign currency swap transactions, including the related income and expense, is allocated to each Reserve Bank based on the ratio of each Reserve Bank's capital and surplus to aggregate capital and surplus at the preceding December 31. Similar to investments denominated in foreign currencies, the foreign currency amounts associated with these central bank liquidity swap arrangements are revalued at current foreign currency market exchange rates.

U.S. dollar liquidity swaps

At the initiation of each U.S. dollar liquidity swap transaction, the foreign central bank transfers a specified amount of its currency to a restricted account for the FRBNY in exchange for U.S. dollars at the prevailing market exchange rate. Concurrent with this transaction, the FRBNY and the foreign central bank agree to a second transaction that obligates the foreign central bank to return the U.S. dollars and the FRBNY to return the foreign currency on a specified future date at the same exchange rate as the initial transaction. The foreign currency that the FRBNY acquires is reported as "Central bank liquidity swaps" on the Combined Statements of Condition. Because the swap transaction will be unwound at the same U.S. dollar amount and exchange rate that was used in the initial transaction, the recorded value of the foreign currency amounts is not affected by changes in the market exchange rate.

The foreign central bank compensates the FRBNY based on the foreign currency amounts held for the FRBNY. The FRBNY recognizes compensation during the term of the swap transaction and reports it as "Interest income: Central bank liquidity swaps" in the Combined Statements of Income and Comprehensive Income.

Foreign currency liquidity swaps

At the initiation of each foreign currency liquidity swap transaction, the FRBNY will transfer, at the prevailing market exchange rate, a specified amount of U.S. dollars to an account for the foreign central bank in exchange for its currency. The foreign currency amount received would be reported as a liability by the Reserve Banks. Concurrent with this transaction, the FRBNY and the foreign central bank agree to a second transaction that obligates the FRBNY to return the foreign currency and the foreign central bank to return the U.S. dollars on a specified future date. The FRBNY compensates the foreign central bank based on the foreign currency transferred to the FRBNY. For each foreign currency swap transaction with a foreign central bank it is anticipated that the FRBNY will enter into a corresponding transaction with a U.S. depository institution in order to provide foreign currency liquidity to that institution. No foreign currency liquidity swap transactions occurred in 2008 or 2009.

(g) Investments Held by Consolidated Variable Interest Entities

Investments of the consolidated VIEs include commercial paper, federal agency and GSE MBS, commercial and residential real estate mortgage loans, non-agency RMBS, CDOs, other investment securities, other real estate owned, and derivatives. These investments are accounted for and classified as follows:

- Commercial paper held by the CPFF is designated as held-to-maturity under FASB ASC Topic 320 (ASC 320), *Investments — Debt and Equity Securities* (previously SFAS 115) according to the terms of the CPFF program. The FRBNY has the positive intent and the ability to hold the securities to maturity and, therefore, the commercial paper is recorded at amortized cost. The amortization of premiums and accretion of discounts is recorded on a straight-line basis that is not materially different from the interest method. Interest income on the commercial paper is reported as "Interest income: Investments held by consolidated variable interest entities" in the Combined Statements of Income and Comprehensive Income. All other investments, consisting of short-term highly liquid assets, held by the CPFF are classified as trading securities under ASC 320 and are recorded at fair value.

  The FRBNY evaluates commercial paper for impairment on a quarterly basis. An investment is impaired if its fair value falls below its recorded value and the decline is considered other-than-temporary. An other-than-temporary-impairment is triggered if (1) the FRBNY has the intent to sell the security, (2) it is more likely than not that the FRBNY will be required to sell the security before recovery of its recorded investment, or (3) the FRBNY does not expect to recover the entire amortized cost basis of the security even if it does not intend to sell the security.

- ML follows the guidance in ASC 320 when accounting for investments in debt securities. ML classifies its debt securities as available for sale and has elected the fair-value option for all eligible assets and liabilities in accordance with ASC 825. Other financial instruments, including derivatives contracts in ML, are recorded at fair value in accordance with FASB ASC Topic 815 (ASC 815), *Derivatives and Hedging* (previously SFAS 133).

- ML II and ML III qualify as non-registered investment companies under the provisions of the American Institute of Certified Public Accountants' *Audit and Accounting Guide for Investment Companies* and, therefore, all investments are recorded at fair value in accordance with FASB ASC Topic 946 (ASC 946), *Financial Services-Investment Companies* (previously the American Institute of Certified Public Accountants *Audit and Accounting Guide for Investment Companies*).

- TALF LLC follows the guidance in ASC 320 when accounting for ABS investments once obtained. All other investments held by the TALF LLC are classified as available for sale securities under

ASC 320 and TALF LLC has elected the fair value option for all eligible assets in accordance with ASC 825. These assets are recorded as "Investments held by consolidated variable interest entities" in the Combined Statements of Condition.

- Interest income, accretion of discounts, amortization of premiums on investments, and paydown gains and losses on federal agency and GSE MBS, non-agency RMBS, and CMOs held by consolidated VIEs are reported in "Interest income: Investments held by consolidated variable interest entities" in the Combined Statements of Income and Comprehensive Income. Realized and unrealized gains (losses) on investments in consolidated VIEs that are recorded at fair value are reported as "Non-interest income (loss): Investments held by consolidated variable interest entities losses, net" in the Combined Statements of Income and Comprehensive Income.

(h) Preferred Securities

As part of the restructuring of the AIG loan, the FRBNY was issued preferred securities in AIA LLC and ALICO LLC, which were created to hold all of the outstanding common stock of AIA and ALICO, respectively. The preferred securities are presented at cost consistent with ASC 320 and are reported on the Combined Statements of Condition as "Preferred securities." The 5 percent cumulative dividend accrued on the preferred securities is reported as "Dividends on preferred securities" on the Combined Statements of Income and Comprehensive Income. On a quarterly basis, the accrued dividends are capitalized and increase the recorded cost of the FRBNY's preferred interest in AIA LLC and ALICO LLC. A preferred security is impaired if its fair value falls below its recorded value and the decline is considered other-than-temporary. An other-than-temporary impairment is triggered if (1) the FRBNY has the intent to sell the security, (2) it is more likely than not that the FRBNY will be required to sell the security before recovery of its recorded investment, or (3) the FRBNY does not expect to recover the entire amortized cost basis of the security even if it does not intend to sell the security. Dividends are accrued unless the impairment analysis indicates that the dividends will not be collected.

(i) Bank Premises, Equipment, and Software

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets, which range from two to 50 years. Major alterations, renovations, and improvements are capitalized at cost as additions to the asset accounts and are depreciated over the remaining useful life of the asset or, if appropriate, over the unique useful life of the alteration, renovation, or improvement. Maintenance, repairs, and minor replacements are charged to operating expense in the year incurred.

Costs incurred for software during the application development stage, whether developed internally or acquired for internal use, are capitalized based on the purchase cost and the cost of direct services and materials associated with designing, coding, installing, and testing the software. Capitalized software costs are amortized on a straight-line basis over the estimated useful lives of the software applications, which range from two to five years. Maintenance costs related to software are charged to expense in the year incurred.

Capitalized assets, including software, buildings, leasehold improvements, furniture, and equipment, are impaired and an adjustment is recorded when events or changes in circumstances indicate that the carrying amount of assets or asset groups is not recoverable and significantly exceeds the assets' fair value.

(j) Federal Reserve Notes

Federal Reserve notes are the circulating currency of the United States. These notes, which are identified as issued to a specific Reserve Bank, must be fully collateralized. Assets eligible to be pledged as collateral security include all of the Reserve Banks' assets. The collateral value is equal to the book value of the collateral tendered with the exception of securities, for which the collateral value is equal to the par value of the securities tendered. The par value of securities pledged for securities sold under agreements to repurchase is deducted.

The Board of Governors may, at any time, call upon a Reserve Bank for additional security to adequately collateralize the outstanding Federal Reserve notes. To satisfy the obligation to provide sufficient collateral for outstanding Federal Reserve notes, the Reserve Banks have entered into an agreement that provides for certain assets of the Reserve Banks to be jointly pledged as collateral for the Federal Reserve notes issued to all Reserve Banks. In the event that this collateral is insufficient, the Federal Reserve Act provides that Federal Reserve notes become a first and paramount lien on all the assets of the Reserve Banks. Finally, Federal Reserve notes are obligations of the United States government. At December 31, 2009 and 2008, all Federal Reserve notes issued to the Reserve Banks were fully collateralized.

"Federal Reserve notes outstanding, net" in the Combined Statements of Condition represents the Federal Reserve notes outstanding, reduced by the Reserve Banks' currency holdings of $193,141 million and $169,681 million at December 31, 2009 and 2008, respectively.

At December 31, 2009, all Federal Reserve notes were fully collateralized. All gold certificates, all special drawing rights certificates, and $871,609 million of domestic securities and securities purchased under agreements to resell were pledged as collateral. At December 31, 2009, no investments denominated in foreign currencies were pledged as collateral.

(k) Beneficial Interest in Consolidated Variable Interest Entities

ML, ML II, ML III, and TALF LLC have outstanding senior and subordinated financial interests, inclusive of a fixed deferred purchase price in ML II and an equity contribution in ML III. Upon issuance of the senior and subordinated financial interests, ML, ML II, ML III, and TALF LLC each elected to measure these obligations at fair value in accordance with ASC 825. Principal, interest, and changes in fair value on the senior financial interest, which were extended by the FRBNY, are eliminated in consolidation. The subordinated financial interest is recorded at fair value as "Beneficial interest in consolidated variable interest entities" in the Combined Statements of Condition. Interest expense and changes in fair value of the subordinated financial interest are recorded in "Interest expense: Beneficial interest in consolidated variable interest entities" and "Non-interest income (loss): Beneficial interest in consolidated variable interest entities losses, net," respectively, in the Combined Statements of Income and Comprehensive Income.

(l) Treasury Supplemental Financing Account and Other Deposits

The Treasury's temporary supplementary program consists of a series of Treasury bill auctions, in addition to Treasury's standard borrowing program. The proceeds of this debt are held in an account at the FRBNY that is separate from the Treasury's general account, and which is reported as "Treasury, supplementary financing account" in the Combined Statements of Condition. The purpose of placing funds in this account is to drain reserves from the banking system and partially offset the reserve impact of the Reserve Bank's lending and liquidity initiatives.

Other deposits represent amounts held in accounts at the Reserve Banks by GSEs and foreign central banks and governments.

(m) Items in Process of Collection and Deferred Credit Items

"Items in process of collection" in the Combined Statements of Condition primarily represents amounts attributable to checks that have been deposited for collection and that, as of the balance sheet date, have not yet been presented to the paying bank. "Deferred credit items" are the counterpart liability to items in process of collection. The amounts in this account arise from deferring credit for deposited items until the amounts are collected. The balances in both accounts can vary significantly.

(n) Capital Paid-in

The Federal Reserve Act requires that each member bank subscribe to the capital stock of the Reserve Bank in an amount equal to six percent of the capital and surplus of the member bank. These shares are nonvoting with a par value of $100 and may not be transferred or hypothecated. As a member bank's capital and surplus changes, its holdings of Reserve Bank stock must be adjusted. Currently, only one-half of the subscription is paid-in and the remainder is subject to call. A member bank is liable for Reserve Bank liabilities up to twice the par value of stock subscribed by it.

By law, each Reserve Bank is required to pay each member bank an annual dividend of six percent on the paid-in capital stock. This cumulative dividend is paid semiannually. To reflect the Federal Reserve Act requirement that annual dividends be deducted from net earnings, dividends are presented as a distribution of comprehensive income in the Combined Statements of Income and Comprehensive Income.

(o) Surplus

The Board of Governors requires the Reserve Banks to maintain a surplus equal to the amount of capital paid-in as of December 31 of each year. Accumulated other comprehensive income is reported as a component of surplus in the Combined Statements of Condition and the Combined Statements of

Changes in Capital. The balance of accumulated other comprehensive income is comprised of expenses, gains, and losses related to the System retirement plan and other postretirement benefit plans that, under GAAP, are included in other comprehensive income, but excluded from net income. Additional information regarding the classifications of accumulated other comprehensive income is provided in Note 15.

(p) Interest on Federal Reserve Notes

The Board of Governors requires the Reserve Banks to transfer excess earnings to the Treasury as interest on Federal Reserve notes after providing for the costs of operations, payment of dividends, and reservation of an amount necessary to equate surplus with capital paid-in. This amount is reported as "Payments to U.S. Treasury as interest on Federal Reserve notes" in the Combined Statements of Income and Comprehensive Income. The amount due to the Treasury is reported as "Accrued interest on Federal Reserve notes" in the Combined Statements of Condition. If overpaid during the year, the amount is reported as "Prepaid interest on Federal Reserve notes" in the Combined Statements of Condition. Payments are made weekly to the Treasury.

In the event of losses or an increase in capital paid-in at a Reserve Bank, payments to the Treasury are suspended and earnings are retained until the surplus is equal to the capital paid-in.

In the event of a decrease in capital paid-in, the excess surplus, after equating capital paid-in and surplus at December 31, is distributed to the Treasury in the following year.

(q) Interest on Depository Institution Deposits

On October 9, 2008, the Reserve Banks began paying interest to depository institutions on qualifying balances held at the Reserve Banks. The interest rates paid on required reserve balances and excess balances are determined by the Board of Governors, based on an FOMC-established target range for the effective federal funds rate.

(r) Income and Costs Related to Treasury Services

The Reserve Banks are required by the Federal Reserve Act to serve as fiscal agent and depositary of the United States Government. By statute, the Department of the Treasury has appropriations to pay for these services. During the years ended December 31, 2009 and 2008, the Reserve Banks were reimbursed for all material services provided to the Department of the Treasury as its fiscal agent.

(s) Assessments by the Board of Governors

The Board of Governors assesses the Reserve Banks to fund its operations based on each Reserve Bank's capital and surplus balances as of December 31 of the prior year. The Board of Governors also assesses each Reserve Bank for the expenses incurred by the Treasury to produce and retire Federal Reserve notes based on each Reserve Bank's share of the number of notes comprising the System's net liability for Federal Reserve notes on December 31 of the prior year.

(t) Taxes

The Reserve Banks are exempt from federal, state, and local taxes, except for taxes on real property. The Reserve Banks' real property taxes were $37 million and $38 million for the years ended December 31, 2009 and 2008, respectively, and are reported as a component of "Occupancy expense."

(u) Restructuring Charges

The Reserve Banks recognize restructuring charges for exit or disposal costs incurred as part of the closure of business activities in a particular location, the relocation of business activities from one location to another, or a fundamental reorganization that affects the nature of operations. Restructuring charges may include costs associated with employee separations, contract terminations, and asset impairments. Expenses are recognized in the period in which the Reserve Banks commit to a formalized restructuring plan or execute the specific actions contemplated in the plan and all criteria for financial statement recognition have been met.

Note 16 describes the Reserve Banks' restructuring initiatives and provides information about the costs and liabilities associated with employee separations and contract terminations. The costs associated with the impairment of certain of the Reserve Banks' assets are discussed in Note 11. Costs and liabilities associated with enhanced pension benefits in connection with the restructuring activities for all of the Reserve Banks are recorded on the books of the FRBNY. Costs and liabilities associated with enhanced postretirement benefits are discussed in Note 14.

In 2009, the Reserve Banks continued their check restructuring initiatives to align check processing infrastructure and operations with declining check processing volumes. Additional announcements in 2009 included restructuring plans associated with discontinuing check print sites.

(v) Recently Issued Accounting Standards

In December 2008, the FASB issued FASB Staff Position (FSP) 132(R)-1, *Employers Disclosures about Postretirement Benefit Plan Assets,* (codified in FASB ASC Topic 715 (ASC 715) *Compensation — Retirement Benefits*). ASC 715 provides rules for the disclosure of information about assets held in a defined benefit plan in the financial statements of the employer sponsoring that plan, and additional disclosures about asset categories and concentrations of risk. It is effective for financial statements with fiscal years ending after December 15, 2009. The disclosures required by ASC 715 have been reflected, as appropriate, in the accompanying footnotes.

In March 2008, FASB issued Statement of Financial Accounting Standards (SFAS) 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133,* (codified in FASB ASC Topic 815 (ASC 815), *Derivatives and Hedging*), which requires expanded qualitative, quantitative, and credit-risk disclosures about derivatives and hedging activities and their effects on a company's financial position, financial performance, and cash flows. These provisions of ASC 815 are effective for the Reserve Banks' combined financial statements for the year beginning on January 1, 2009 and have not had a material effect on the Reserve Banks' combined financial statements. The disclosure requirements have been reflected, as appropriate, in Note 9.

In February 2008, FASB issued FSP SFAS 140-3, *Accounting for Transfers of Financial Assets and Repurchase Financing Transactions,* (codified in FASB ASC Topic 860 (ASC 860), *Transfers and Servicing*). ASC 860 requires that an initial transfer of a financial asset and a repurchase financing that was entered into contemporaneously with, or in contemplation of, the initial transfer be evaluated together as a linked transaction unless certain criteria are met. These provisions of ASC 860 are effective for the Reserve Banks' combined financial statements for the year beginning on January 1, 2009 and have not had a material effect on the Reserve Banks' combined financial statements. The requirements of this standard have been reflected in the accompanying footnotes.

In June 2009, FASB issued SFAS 166, *Accounting for Transfers of Financial Assets—an amendment to FASB Statement No. 140,* (codified in FASB ASC 860). The new guidance modifies existing guidance to eliminate the scope exception for qualifying SPVs and clarifies that the transferor must consider all arrangements of the transfer of financial assets when determining if the transferor has surrendered control. These provisions of ASC 860 are effective for the Reserve Banks' combined financial statements for the year beginning on January 1, 2010, and earlier adoption is prohibited. The adoption of this standard is not expected to have a material effect on the Reserve Banks' combined financial statements.

In April 2009, FASB issued FSP SFAS 115-2 and SFAS 124-2, *Recognition and Presentation of Other-Than-Temporary-Impairments,* (codified in FASB ASC Topic 320 (ASC 320) *Investment-Debt and Equity Securities*), which amends the other-than-temporary impairment guidance for debt securities and the financial statement presentation and disclosure requirements. These provisions of ASC 320, which are effective for the Reserve Banks' combined financial statements ended December 31, 2009, have not had a material effect on the Reserve Banks' combined financial statements.

In April 2009, FASB issued FSP 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly,* (codified in FASB ASC Topic 820 (ASC 820), *Fair Value Measurements and Disclosures*) which provides additional guidance for estimating fair value when the value and level of market activity for an asset or liability have significantly decreased. The standard also provides guidance on identifying circumstances that indicate a transaction is not orderly. The provisions of the FSP, which are effective for the Reserve Banks' combined financial statements for the year ending December 31, 2009, were considered in determining the valuation of assets and liabilities that are measured at fair value. The adoption of this provision did not have a material effect on the Reserve Banks' combined financial statements.

In May 2009, FASB issued SFAS No. 165, *Subsequent Events,* (codified in FASB ASC Topic 855 (ASC 855), *Subsequent Events*), which establishes general standards of accounting for and disclosing events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855 sets forth (i) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (ii) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; and (iii) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date, including disclosure of the date through which an entity has evaluated subsequent events and whether that represents the date the financial statements were issued or were available to be issued. The Reserve Banks adopted ASC 855 for the period ended December 31, 2009 and the required disclosures are reflected in Note 17.

In June 2009, FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R),* (codified in FASB ASC 810), which expands the scope of Interpretation 46R, *Consolidation of Variable Interest Entities* and changes the approach for determining whether an entity has a controlling interest in a VIE by making a qualitative assessment of its financial interests. Additional disclosures are required for a variable interest in a VIE. These provisions of ASC 810 are effective for the Reserve Banks' combined financial statements for the year beginning on January 1, 2010, and earlier adoption is prohibited. The adoption of this standard is not expected to have a material effect on the Reserve Banks' combined financial statements.

In June 2009, the FASB issued SFAS No. 168, *The Statement of Financial Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles,* a replacement of SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS 168). SFAS 168 establishes the FASB ASC as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. The ASC does not change current GAAP, but it introduces a new structure that organizes the authoritative standards by topic. SFAS 168 is effective for financial statements issued for periods ending after September 15, 2009. As a result, both the ASC and the legacy standard are referenced in the Reserve Banks' combined financial statements and footnotes.

In January 2010, the FASB issued *Accounting Standards Update 2010-06,* (codified in FASB ASC Topic 820 (ASC 820), *Fair Value Measurements and Disclosures*) which requires additional disclosures related to fair value measurements. This update is effective for the Reserve Banks' combined financial statements for the year beginning on January 1, 2010 and early adoption is prohibited. The adoption of this update is not expected to have a material effect on the Reserve Banks' combined financial statements.

(5) Loans

The loan amounts outstanding at December 31 were as follows (in millions):

	2009	2008
Primary, secondary, and seasonal credit	$20,700	$ 93,790
TAF	75,918	450,220
Loans to depository institutions	$96,618	$544,010
AMLF	$ -	$ 23,765
PDCF	-	37,404
TALF loans, fair value	48,183	-
AIG	22,738	38,913
Other loans	70,921	100,082
Allowance for loan restructuring (AIG)	(1,488)	-
Other loans, net	$69,433	$100,082

The remaining maturity distributions, net of allowance, of loans outstanding at December 31 were as follows (in millions):

	2009			
	Primary, secondary, and seasonal credit	TAF	TALF loans, fair value	AIG, net
Within 15 days	$16,304	$75,918	$ -	$ -
16 to 90 days	4,396	-	-	-
Over 1 year to 5 years	-	-	48,183	21,250
Total loans	$20,700	$75,918	$48,183	$21,250

	2008				
	Primary, secondary, and seasonal credit	TAF	AMLF	PDCF	AIG
Within 15 days	$85,846	$235,424	$ 9,682	$37,404	$ -
16 to 90 days	7,944	214,796	14,083	-	-
Over 1 year to 5 years	-	-	-	-	38,913
Total loans	$93,790	$450,220	$23,765	$37,404	$38,913

Loans to depository institutions

The Reserve Banks offer primary, secondary, and seasonal credit to eligible borrowers. Each program has its own interest rate. Interest is accrued using the applicable interest rate established at least every 14 days by the Reserve Banks' boards of directors, subject to review and determination by the Board of Governors. Primary and secondary credit are extended on a short-term basis, typically overnight, whereas seasonal credit may be extended for a period of up to nine months.

Primary, secondary, and seasonal credit lending is collateralized to the satisfaction of the Reserve Banks to reduce credit risk. Assets eligible to collateralize these loans include consumer, business, and real estate loans; Treasury securities; GSE debt securities; foreign sovereign debt; municipal, corporate, and state and local government obligations; ABS; corporate bonds; commercial paper; and bank-issued assets, such as certificates of deposit, bank notes, and deposit notes. Collateral is assigned a lending value that is deemed appropriate by the Reserve Banks, which is typically fair value or face value reduced by a margin.

Depository institutions that are eligible to borrow under the Reserve Banks' primary credit program are also eligible to participate in the TAF program. Under the TAF program, the Reserve Banks conduct auctions for a fixed amount of funds, with the interest rate determined by the auction process, subject to a minimum bid rate. TAF loans are extended on a short-term basis, with terms ranging from 28 to 84 days. All advances under the TAF program must be collateralized to the satisfaction of the Reserve Banks. Assets eligible to collateralize TAF loans include the complete list noted above for loans to depository institutions. Similar to the process used for primary, secondary, and seasonal credit, a lending value is assigned to each asset that is accepted as collateral for TAF loans reduced by a margin.

Loans to depository institutions are monitored on a daily basis to ensure that borrowers continue to meet eligibility requirements for these programs. The financial condition of borrowers is monitored by the Reserve Banks and, if a borrower no longer qualifies for these programs, the Reserve Banks will generally request full repayment of the outstanding loan or, for primary and seasonal credit lending, may convert the loan to a secondary credit loan. Collateral levels are reviewed daily against outstanding obligations and borrowers that no longer have sufficient collateral to support outstanding loans are required to provide additional collateral or to make partial or full repayment.

At December 31, 2009 and 2008, the FRBNY did not have any impaired loans to depository institutions and no allowance for loan losses was required.

Other loans

AMLF

The FRBB administered the AMLF and was authorized to extend loans to eligible borrowers on behalf of the other Reserve Banks. All loans extended under the AMLF were recorded as assets by the FRBB and, if the borrowing institution settled to a depository account in another Reserve Bank District, the funds were credited to the institution's depository account by the appropriate Reserve Bank and settled between the Banks through the interdistrict settlement account. The loans extended under the AMLF were nonrecourse, so that the FRBB had recourse only to the collateral pledged by the borrowers. The credit risk related to the AMLF was assumed by the FRBB. No losses were incurred on loans extended during the years ended December 31, 2009 and 2008. Eligible collateral under the program was limited to U.S. dollar-denominated ABCP that was not rated lower than A-1/P-1/F1 and was required to be purchased from an eligible money market mutual fund. The terms of loans under the AMLF were limited to 120 days if the borrower was a bank or 270 days for nonbank borrowers. The interest rate for advances made under the AMLF was equal to the FRBB's primary credit rate offered to depository institutions at the time the advance was made.

At December 31, 2009, the FRBB did not have any AMLF loans outstanding. At December 31, 2008, no AMLF loans were impaired and no allowance for loan losses was required.

PDCF

The PDCF provided secured overnight financing to primary dealers in exchange for a specified range of collateral, including Treasury securities; federal agency and GSE MBS; other MBS; municipal securities; ABS; and money market equities, for which prices were available. Interest on PDCF secured financing was accrued using the primary credit rate offered by the Reserve Banks to depository institutions. The secured financing is reported as a component of "Other loans" in the Combined Statements of Condition. The frequency-based fees are reported as "Other income" in the Combined Statements of Income and Comprehensive Income.

At December 31, 2009, the Reserve Banks did not have any PDCF loans outstanding. At December 31, 2008, no PDCF loans were impaired and no allowance for loan losses was required.

TALF

Credit extensions under TALF are nonrecourse loans secured by eligible collateral. Each TALF loan has a three-year maturity, except for loans secured by SBA Pool Certificates, loans secured by SBA Development Company Participation Certificates, or ABS backed by student loans or commercial mortgage loans, which have a five-year maturity if the borrower so elects.

The FRBNY has elected the fair value option for all TALF loans under ASC 825. Recording all TALF loans at fair value, rather than at the remaining principal amount outstanding, results in consistent accounting treatment among all TALF-related transactions and provides the most appropriate presentation of the TALF program on the financial statements by matching the change in fair value of TALF loans, the related put agreement with the consolidated TALF LLC, and the valuation of the other beneficial interests in TALF LLC. Additional information regarding the TALF LLC assets and liabilities is presented in Note 9.

In certain cases where there is limited activity around inputs to the valuation, loans are classified within Level 3 of the valuation hierarchy. Because external price information was not available, market-based models were used to determine the fair value of the TALF loans. The fair value of the TALF loans was determined by valuing the future cash flows from loan interest income and the estimated fair value losses associated with collateral that may be put to the FRBNY. The valuation model takes into account a range of outcomes on TALF loan repayments, market prices of the collateral, risk premiums estimated using market prices, and the volatilities of market risk factors. Other methodologies employed or assumptions made in determining fair value could result in an amount that differs significantly from the amount reported.

The following table presents the TALF loans at fair value as of December 31, 2009, by ASC 820 hierarchy (in millions):

	Fair value hierarchy			Total
	Level 1	Level 2	Level 3	fair value
TALF loans	$ -	$ -	$48,183	$48,183

The table below presents a reconciliation of the TALF loans, which are measured at fair value using significant unobservable inputs (Level 3) during the period February 4, 2009 to December 31, 2009 (in millions):

	Fair Value at February 4, 2009	Loans originated[1]	Unrealized gains	Transfers out[2]	Fair Value at December 31, 2009
TALF loans	$ -	$61,626	$557	$(14,000)	$48,183

1. Loans originated includes $52 million in accrued interest receivable.
2. Net transfers out represent principal prepayments.

The fair value of TALF loans reported in the Combined Statements of Condition at December 31, 2009 includes $557 million in unrealized gains. FRBNY attributes substantially all changes in fair value of nonrecourse loans to changes in instrument specific credit spreads.

The table below presents principal and accrued interest by concentration for the TALF loans as of December 31, 2009 (in millions):

	Concentration of Unpaid Principal Balance and Accrued Interest			
	Years to Maturity			Percent
Collateral Type and Credit Rating	1–3	4–5	Total	of Total
Auto (AAA)	$ 5,851	$ -	$ 5,851	12%
CMBS (AA)	-	25	25	0%
CMBS (AAA)	3,572	4,941	8,513	18%
Credit Card (AAA)	20,297	-	20,297	43%
Floorplan (AAA)	2,427	-	2,427	5%
SBAs (AAA)	915	357	1,272	3%
Student Loan (AAA)	2,236	4,168	6,404	13%
Other (AAA)[1]	2,837	-	2,837	6%
Total	$38,135	$9,491	$47,626	100%

1. Includes equipment, servicing advances, and premium finance ABS.

The aggregate remaining principal amount outstanding on TALF loans as of December 31, 2009 was $47,574 million.

At December 31, 2009, no TALF loans were over 90 days past due or in nonaccrual status. Because the TALF loans are measured at fair value, an allowance for loan losses was not required.

AIG

The $21,250 million extended to AIG under the revolving line of credit is net of unamortized deferred commitment fees and allowance for restructuring and includes unpaid commitments fees and accrued interest. The AIG loan is reported as a component of “Other loans” in the Combined Statements of Condition.

The table below represents the components of the loan amounts outstanding to AIG at December 31.

AIG Loan Components	2009	2008
Line of credit drawn	$17,900	$36,800
Accrued interest	3,835	1,931
Unpaid commitment fees	1,700	1,700
Unamortized deferred commitment fees	(697)	(1,518)
Allowance for loan restructuring, net	(1,488)	-
Loan to AIG, net	$21,250	$38,913

The fair value of the AIG line of credit provided by the FRBNY, based on estimated draws and repayments, was not materially different from the net amount reported as a component of “Other loans” in the Combined Statements of Condition as of December, 31, 2009.

The activity related to the allowance for loan restructuring for the year ended December 31, 2009 was as follows (in millions):

	Allowance for Loan Restructuring January 1, 2009	Provision for Loan Restructuring	Recoveries	Allowance for Loan Restructuring December 31, 2009
AIG loan	$ -	$(2,621)	$1,133	$(1,488)

The allowance for loan restructuring represents the economic effect of the reduction of the interest rate on loans the FRBNY made to AIG prior to April 17, 2009, as part of the loan restructuring that occurred on that date. The restructuring charges will be recovered over the remaining term of the related loan. The allowance outstanding, net of amortized recoveries, is deducted from “Other loans” in the Combined Statements of Condition and recoveries are reported as a component of “Interest income: Other loans” on the Combined Statements of Income and Comprehensive Income. The average balance of the credit extensions to AIG under the revolving line of credit, net of the allowance for restructuring, during the year ended December 31, 2009 was $39,099 million. Interest income recognized on credit extensions to AIG during the year ended December 31, 2009 was $3,996 million. No interest income was foregone after the recorded restructuring.

(6) Treasury Securities; Government-Sponsored Enterprise Debt Securities; Federal Agency and Government-Sponsored Enterprise Mortgage-Backed Securities; Securities Purchased Under Agreements To Resell; Securities Sold Under Agreements to Repurchase; and Securities Lending

The FRBNY, on behalf of the Reserve Banks, holds securities bought outright in the SOMA.

The total of the Treasury securities, GSE debt securities, and federal agency and GSE MBS, net, excluding accrued interest, held in the SOMA at December 31 was as follows (in millions):

	2009					
	Treasury securities					
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities	Federal agency and GSE MBS
Par	$18,423	$568,323	$189,843	$776,588	$159,879	$908,371
Unamortized premiums	-	6,545	24,460	31,005	7,509	12,110
Unaccreted discounts	-	(991)	(630)	(1,621)	(26)	(1,554)
Total amortized cost	$18,423	$573,877	$213,673	$805,972	$167,362	$918,927
Fair Value	$18,422	$583,040	$230,717	$832,180	$167,444	$914,290

	2008				
	Treasury securities				
	Bills	Notes	Bonds	Total Treasury securities	GSE debt securities
Par	$18,423	$334,779	$122,719	$475,921	$19,708
Unamortized premiums	-	274	6,711	6,985	1,064
Unaccreted discounts	-	(837)	(620)	(1,457)	(32)
Total amortized cost	$18,423	$334,216	$128,810	$481,449	$20,740
Fair Value	$18,423	$357,709	$169,433	$545,564	$20,863

The fair value amounts in the above tables are presented solely for informational purposes. Although the fair value of security holdings can be substantially greater than or less than the recorded value at any point in time, these unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet their financial obligations and responsibilities. Fair value was determined by reference to quoted market values for identical securities, except for federal agency and GSE MBS for which fair values were determined using a model-based approach based on observable inputs for similar securities.

The fair value of the fixed-rate Treasury securities, GSE debt securities, and federal agency and GSE MBS in the SOMA's holdings is subject to market risk, arising from movements in market variables, such as interest rates and securities prices. The fair value of federal agency and GSE MBS is also affected by the rate of prepayments of mortgage loans underlying the securities.

The following table provides additional information on the amortized cost and fair values of the federal agency and GSE MBS portfolio at December 31, 2009 (in millions):

Distribution of MBS holdings by coupon rate	Amortized cost	Fair value
4.0%	$170,119	$165,740
4.5%	434,352	431,646
5.0%	195,418	196,411
5.5%	103,379	104,583
6.0%	12,710	12,901
Other[1]	2,949	3,009
Total	$918,927	$914,290

1. Represents less than one percent of the total portfolio

Financial information related to securities purchased under agreements to resell and securities sold under agreements to repurchase for the years ended December 31, 2009 and 2008, was as follows (in millions):

	Securities purchased under agreements to resell		Securities sold under agreements to repurchase	
	2009	2008	2009	2008
Contract amount outstanding, end of year	$ -	$ 80,000	$77,732	$88,352
Average daily amount outstanding, during the year	3,616	86,227	67,837	55,169
Maximum month-end balance outstanding, during the year	-	119,000	77,732	98,559
Securities pledged, end of year	-	-	77,860	78,896

The Reserve Banks revised the disclosure of securities purchased under agreements to resell and securities sold under agreements to repurchase from a weighted average calculation, disclosed in 2008, to the simple daily average calculation, disclosed above. The previously reported Reserve Bank total 2008 weighted average amount outstanding for securities purchased under agreements to resell was $97,037 million. The previously reported Reserve Bank total 2008 weighted average amount outstanding for securities sold under agreements to repurchase was $65,461 million.

The contract amounts for securities purchased under agreements to resell and securities sold under agreements to repurchase approximate fair value.

The remaining maturity distribution of Treasury securities, GSE debt securities, federal agency and GSE MBS bought outright, securities purchased under agreements to resell, and securities sold under agreements to repurchase at December 31, 2009 was as follows (in millions):

	Treasury securities (Par value)	GSE debt securities (Par value)	Federal agency and GSE MBS (Par value)	Securities purchased under agreements to resell (Contract amount)	Securities sold under agreements to repurchase (Contract amount)
Within 15 days	$ 11,617	$ 68	$ -	$-	$77,732
16 days to 90 days	28,853	3,046	-	-	-
91 days to 1 year	50,771	21,528	-	-	-
Over 1 year to 5 years	326,874	99,402	12	-	-
Over 5 years to 10 years	213,720	33,788	20	-	-
Over 10 years	144,753	2,047	908,339	-	-
Total	$776,588	$159,879	$908,371	$-	$77,732

Federal agency and GSE MBS are reported at stated maturity in the table above. The estimated weighted average life of these securities at December 31, 2009, which differs from the stated maturity primarily because it factors in prepayment assumptions, is approximately 6.4 years.

At December 31, 2009 and 2008, Treasury securities and GSE debt securities with par values of $21,610 million and $180,765 million, respectively, were loaned from the SOMA.

At December 31, 2009, the total of other investments was $5 million. Other investments consist of cash and short-term investments related to the federal agency and GSE MBS portfolio.

At December 31, 2009, the total of other liabilities was $601 million. These other liabilities, which are related to purchases of federal agency and GSE MBS, arise from the failure of a seller to deliver securities to the FRBNY on the settlement date. Although the FRBNY has ownership of and records its investments in the MBS as of the contractual settlement date, it is not obligated to make payment until the securities are delivered, and the amount reported as other liabilities represents the Reserve Banks' obligation to pay for the securities when delivered.

The FRBNY enters into commitments to buy federal agency and GSE MBS and records the related MBS on a settlement-date basis. As of December 31, 2009, the total purchase price of the federal agency and GSE MBS under outstanding commitments was $160,099 million, of which $32,838 million was related to dollar rolls. These commitments, which had contractual settlement dates extending through March 2010, are primarily for the purchase of TBA MBS for which the number and identity of the pools that will be delivered to fulfill the commitment are unknown at the time of the trade. These commitments are subject to market and counterparty risks that result from their future settlement. As of December 31, 2009, the fair value of federal agency and GSE MBS under outstanding commitments was $158,868 million. During the year ended December 31, 2009, the Reserve Banks recorded net gains from dollar roll related sales of $879 million. These net gains are reported as "Non-Interest Income (Loss): Federal agency and government-sponsored enterprise mortgage-backed securities gains, net" in the Combined Statements of Income and Comprehensive Income.

(7) Investments Denominated In Foreign Currencies

The FRBNY, on behalf of the Reserve Banks, holds foreign currency deposits with foreign central banks and with the Bank for International Settlements and invests in foreign government debt instruments. These investments are guaranteed as to principal and interest by the issuing foreign governments. In addition, the FRBNY enters into transactions to purchase foreign-currency-denominated government-debt securities under agreements to resell for which the accepted collateral is the debt instruments issued by the governments of Belgium, France, Germany, Italy, the Netherlands, and Spain.

The Reserve Banks' investments denominated in foreign currencies, including accrued interest, valued at amortized cost and foreign currency market exchange rates at December 31, was as follows (in millions):

	2009	2008
Euro:		
Foreign currency deposits	$ 7,396	$ 5,563
Securities purchased under agreements to resell	2,591	4,076
Government debt instruments	4,936	4,609
Japanese yen:		
Foreign currency deposits	3,403	3,483
Government debt instruments	6,946	7,073
Total	$25,272	$24,804

At December 31, 2009 and 2008, the fair value of investments denominated in foreign currencies, including accrued interest, was $25,480 million and $25,021 million, respectively. The fair value of government debt instruments was determined by reference to quoted prices for identical securities. The cost basis of foreign currency deposits and securities purchased under agreements to resell, adjusted for accrued interest, approximates fair value. Similar to the Treasury securities, GSE debt securities, and federal agency and GSE MBS discussed in Note 6, unrealized gains or losses have no effect on the ability of the Reserve Banks, as the central bank, to meet its financial obligations and responsibilities. The fair value is presented solely for informational purposes.

The remaining maturity distribution of investments denominated in foreign currencies at December 31, 2009 was as follows (in millions):

	Euro	Japanese yen	Total
Within 15 days	$ 6,067	$ 3,623	$ 9,690
16 days to 90 days	2,505	463	2,968
91 days to 1 year	2,408	2,368	4,776
Over 1 year to 5 years	3,943	3,895	7,838
Total	$14,923	$10,349	$25,272

At December 31, 2009 and 2008, the authorized warehousing facility was $5 billion, with no balance outstanding.

In connection with its foreign currency activities, the FRBNY may enter into transactions that contain varying degrees of off-balance-sheet market risk that result from their future settlement and counterparty credit risk. The FRBNY controls these risks by obtaining credit approvals, establishing transaction limits, receiving collateral in some cases, and performing daily monitoring procedures.

(8) Central Bank Liquidity Swaps

U.S. Dollar Liquidity Swaps

At December 31, 2009 and 2008, the total Reserve Bank amount of foreign currency held under U.S. dollar liquidity swaps was $10,272 million and $553,728 million, respectively.

The remaining maturity distribution of U.S. dollar liquidity swaps at December 31 was as follows (in millions):

	2009			2008		
	Within 15 days	16 days to 90 days	Total	Within 15 days	16 days to 90 days	Total
Australian dollar	$ -	$-	$ -	$ 10,000	$ 12,830	$ 22,830
Danish krone	-	-	-	-	15,000	15,000
Euro	6,506	-	6,506	150,969	140,383	291,352
Japanese yen	545	-	545	47,893	74,823	122,716
Korean won	-	-	-	-	10,350	10,350
Mexican peso	3,221	-	3,221	-	-	-
Norwegian krone	-	-	-	2,200	6,025	8,225
Swedish krona	-	-	-	10,000	15,000	25,000
Swiss franc	-	-	-	19,221	5,954	25,175
U.K. pound	-	-	-	120	32,960	33,080
Total	$10,272	$-	$10,272	$240,403	$313,325	$553,728

Foreign Currency Liquidity Swaps

There were no transactions related to the foreign currency liquidity swaps during the years ended December 31, 2008 and 2009.

(9) Investments Held By Consolidated Variable Interest Entities

The combined financial statements include the accounts and results of operations of several VIEs, specifically ML, ML II, ML III, CPFF and TALF LLC. The consolidation of the VIEs was assessed in accordance with ASC 810, which requires a variable interest entity to be consolidated by its controlling financial interest holder.

(a) Summary Information for Consolidated Variable Interest Entities

The total assets of consolidated VIEs, including cash, cash equivalents, and accrued interest, at December 31 were as follows (in millions):

	2009	2008
CPFF	$14,233	$334,910
ML	28,140	30,635
ML II	15,912	19,195
ML III	22,797	27,256
TALF LLC	298	-
Total	$81,380	$411,996

The FRBNY's maximum exposure to loss at December 31, 2009 and 2008 was $73,879 million and $405,377 million, respectively. These estimates incorporate potential losses associated with assets recorded on the FRBNY's balance sheet, net of the fair value of subordinated interests (beneficial interest in consolidated VIEs).

The classification of significant assets and liabilities of the consolidated VIEs at December 31 was as follows (in millions):

	2009	2008
Assets:		
Commercial paper	$ 9,421	$333,631
CDOs	22,650	26,957
Non-agency RMBS	17,552	20,675
Federal agency and GSE MBS	18,149	15,654
Commercial mortgage loans	4,025	5,553
Residential mortgage loans	583	937
Swap contracts	1,127	2,454
Other investments	5,467	2,340
Subtotal	$78,974	$408,201
Cash, cash equivalents, and accrued interest receivable	2,406	3,795
Total investments held by consolidated variable interest entities	$81,380	$411,996
Liabilities:		
Beneficial interest in consolidated variable interest entities	$ 5,095	$ 2,824
Other liabilities[1]	$ 1,316	$ 5,813

1. The amounts reported as "Consolidated variable interest entities: Other liabilities" in the Combined Statements of Condition at December 31, 2009 included $980 million related to cash collateral received on swap contracts and at December 31, 2008 included $2,572 million related to cash collateral received on swap contracts and $2,369 million payable for investments purchased by VIEs. The amount also included accrued interest, unearned registration fees, and accrued other expenses.

Total realized gains (losses) and unrealized gains (losses) for the 12 months ended December 31, 2009, were as follows (in millions):

	Total portfolio holdings realized gains (losses)	Fair value changes unrealized gains (losses)	Total portfolio holdings realized/ unrealized gains (losses)
CDOs	$ (3)	$(1,211)	$(1,214)
Non-agency RMBS	217	(991)	(774)
Federal agency and GSE MBS	322	521	843
Commercial mortgage loans	(47)	(1,177)	(1,224)
Residential mortgage loans	(48)	(219)	(267)
Swap contracts	(119)	212	93
Other investments	12	712	724
Other assets	(182)	64	(118)
Total	$ 152	$(2,089)	$(1,937)

Total realized gains (losses) and unrealized gains (losses) for the 12 months ended December 31, 2008, were as follows (in millions):

	Total portfolio holdings realized gains (losses)	Fair value changes unrealized gains (losses)	Total portfolio holdings realized/ unrealized gains (losses)
CDOs	$ -	$(3,281)	$(3,281)
Non-agency RMBS	(4)	(3,001)	(3,005)
Federal agency and GSE MBS	(166)	50	(116)
Commercial mortgage loans	42	(2,130)	(2,088)
Residential mortgage loans	(3)	(563)	(566)
Swap contracts	(70)	155	85
Other investments	237	(892)	(655)
Total	$ 36	$(9,662)	$(9,626)

The net income (loss) attributable to ML, ML II, ML III and CPFF for the 12 months ended December 31, 2009 and for TALF LLC for the period from inception to December 31, 2009 was as follows (in millions):

	ML	ML II	ML III	CPFF	TALF LLC	Total
Interest income:						
Portfolio interest income	$1,476	$1,088	$ 3,032	$4,224	$ -	$ 9,820
Less: Interest expense	61	33	171	-	2	267
Net interest income	1,415	1,055	2,861	4,224	(2)	9,553
Non-interest income:						
Portfolio holdings gains (losses)	(102)	(604)	(1,239)	8	-	(1,937)
Less: Unrealized gains (losses) on beneficial interest in consolidated VIEs	61	34	(1,299)	-	(699)[1]	(1,903)
Net non-interest income (loss)	(41)	(570)	(2,538)	8	(699)	(3,840)
Total net interest income and non-interest income	1,374	485	323	4,232	(701)	5,713
Less: Professional fees	55	12	27	30	1	125
Net income (loss) attributable to consolidated VIEs	$1,319	$ 473	$ 296	$4,202	$(702)[2]	$ 5,588

1. The TALF LLC reported net operating income of $776 million for the period from inception to December 31, 2009 includes gains of $557 million on the put option between FRBNY and TALF LLC that are eliminated in consolidation. The unrealized loss on beneficial interest in consolidated VIEs represent Treasury's 90 percent financial interest in the TALF LLC's net operating income before consolidation.

2. The FRBNY earned $1,025 million on TALF loans during the year ended December 31, 2009 which offsets the net loss attributable to TALF LLC. Earnings on TALF loans that are reported on the Combined Statements of Income include interest income of $414 million reported as a component of "Interest income: Other loans, net," gains on the valuation of loans of $557 reported as "Non-Interest Income (Loss): Other loans unrealized gains," and administrative fees of $54 million reported as a component of "Non-Interest Income (Loss): Other income."

The net income (loss) attributable to consolidated VIEs from inception through December 31, 2008 was as follows (in millions):

	ML	ML II	ML III	CPFF	Total
Interest income:					
Portfolio interest income	$ 1,561	$ 302	$ 517	$1,707	$ 4,087
Less: Interest expense	332	103	28	-	463
Net interest income	1,229	199	489	1,707	3,624
Non-interest income:					
Portfolio holdings (losses) gains	(5,497)	(1,499)	(2,633)	3	(9,626)
Less: Unrealized gains on beneficial interest in consolidated VIEs	1,188	1,003	2,198	-	4,389
Net non-interest (loss) income	(4,309)	(496)	(435)	3	(5,237)
Total net interest income and non-interest income	(3,080)	(297)	54	1,710	(1,613)
Less: Professional fees	54	5	9	12	80
Net income (loss) attributable to consolidated VIEs	$(3,134)	$ (302)	$ 45	$1,698	$(1,693)

The subordinated financial interest of the consolidated VIEs from inception through December 31, 2009 is as follows (in millions):

	ML subordinated loan	ML II deferred purchase price	ML III equity contribution	TALF Treasury contribution	Total
Beginning principal in 2008	$ 1,150	$ 1,000	$ 5,000	$ -	$ 7,150
Interest accrued and capitalized	38	3	22	-	63
Ending principal balance	1,188	1,003	5,022	-	7,213
Unrealized (gain)	(1,188)	(1,003)	(2,198)	-	(4,389)
Balance at December 31, 2008	$ -	$ -	$ 2,824	$ -	$ 2,824
Treasury loan	$ -	$ -	$ -	$100	$ 100
Interest accrued and capitalized	61	34	171	2	268
Ending principal balance	61	34	2,995	102	3,192
Unrealized (gain)/loss	(61)	(34)	1,299	699	1,903
Balance at December 31, 2009	$ -	$ -	$ 4,294	$801	$ 5,095

(b) Commercial Paper Funding Facility LLC

The CPFF Program charged a lending rate for unsecured commercial paper equal to a three-month OIS rate plus 100 basis points per annum, with an additional surcharge of 100 basis points per annum for an unsecured credit enhancement fee. The interest rate for ABCP is the three-month OIS rate plus 300 basis points.

Unsecured commercial paper issuers covered by the FDIC Temporary Liquidity Guarantee Program are viewed as having a satisfactory guarantee and the credit enhancement fee for those participants is waived. The credit enhancement fee is amortized on a straight-line basis over the term of the commercial paper, which is not materially different from the interest method. The registration fees are amortized on a straight-line basis over the life of the program, which is not materially different from the interest method.

The FRBNY conducts a periodic review of the CPFF's commercial paper to determine if impairment is other than temporary such that a loss should be recognized. At December 31, 2009 there were no commercial paper securities for which management considered impairments to be other than temporary.

The remaining maturity distribution of the commercial paper and trading securities held by the CPFF at December 31, 2009 was as follows (in millions):

	Commerical paper			
	Asset backed	Non-asset backed	Trading securities	Total
Within 15 days	$ -	$ -	$ 1	$ 1
16 days to 60 days	7,422	1,999	30	9,451
61 days to 92 days	-	-	2,364	2,364
93 days to 124 days	-	-	2,392	2,392
Total	$7,422	$1,999	$4,787	$14,208

Top-tier commercial paper has received the highest ratings (A-1, P-1, F1) from all rating agencies that provide a rating for the paper. Split-rated commercial paper has received a top tier rating from two rating agencies and second tier rating (A-2, P-2, F2) from a third rating agency. All of the commercial paper held by the CPFF at December 31, 2009 was top-tier. The credit ratings profile of the commercial paper held by the CPFF by asset type, issuer type, and industry sector, at December 31, 2009 was as follows (in millions):

	Commerical paper
Asset backed	
Multi-seller	$3,583
Securities arbitrage	2,741
Structured investment vehicle	1,088
Investment company	10
	7,422
Non-asset backed	
Insurance	1,999
	1,999
Total	$9,421

The largest issuer, an asset-backed commercial paper conduit of a diversified financial company, represents 29 percent of the total commercial paper portfolio holdings at December 31, 2009. This entity and affiliates of this entity, together, represent 62 percent of the total commercial paper portfolio held at December 31, 2009.

(c) Maiden Lane LLC

ML's investment portfolio consists primarily of federal agency and GSE MBS, non-agency RMBS, commercial and residential mortgage loans, and derivatives. A description of the significant holdings at December 31, 2009 and the associated credit risk for each holding follows.

i. Debt Securities

ML has investments in federal agency and GSE MBS, which represent fractional ownership interests in RMBS issued by federal agencies and GSEs. The yield characteristics of these securities may differ from traditional debt securities. One such major difference is that all or a principal part of the obligations may be prepaid at any time because the underlying mortgages may be prepaid at any time. A portion of ML's investments include interest only ("IO") or principal only ("PO") security classes. The IO class receives the interest cash flows from the underlying mortgages, while the PO class receives the principal cash flows. The yield to maturity on these securities is sensitive to the rate of principal repayments (including prepayments) on the related underlying mortgage assets. The principal prepayments may have a material effect on yield to maturity. If the underlying mortgage assets experience greater-than-anticipated prepayments of principal, ML may not fully recoup its initial investment in IO classes.

The yield to maturity on the PO classes may be impacted by delinquencies or defaults on the underlying mortgage assets. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses can be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located, the level of the borrower's equity in the mortgaged property and the individual financial circumstances of the borrower. Changes in economic conditions, including delinquencies and defaults on the underlying mortgages, can affect the value, income, and liquidity of ML's positions.

ML's non-agency RMBS investments expose ML to varying levels of credit, interest rate, general market, and concentration risk. Credit-related risk on non-agency RMBS arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the non-agency RMBS are issued. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses can be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower.

The rate of interest payable on certain non-agency RMBS may be set or effectively capped at the weighted average net coupon of the underlying mortgage loans themselves, often referred to as an "available funds cap." As a result of this available funds cap, the return to ML on such non-agency RMBS is dependent on the relative timing and rate of delinquencies and prepayments of mortgage loans bearing a higher interest rate.

As of December 31, 2009, approximately 51 percent of the properties collateralizing the non-agency RMBS held by ML were located in California and Florida, based on the geographic location data available for the underlying loans by aggregate unpaid principal balance.

Other investments are primarily comprised of CMBS and CDOs.

At December 31, 2009, the ratings breakdown of the $20,965 million of debt securities, which are recorded at fair value in the ML portfolio, as a percentage of aggregate fair value of all securities in the portfolio was as follows:

	Ratings[1]						
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and Lower	Govern-ment / Agency	Total
Security Type:[2]							
Federal agency and GSE MBS	0.0%	0.0%	0.0%	0.0%	0.0%	86.6%	86.6%
Non-agency RMBS	0.5%	0.5%	0.8%	0.3%	7.0%	0.0%	9.1%
Other[3]	1.2%	0.6%	0.5%	0.7%	1.2%	0.1%	4.3%
Total	1.7%	1.1%	1.3%	1.0%	8.2%	86.7%	100.0%

1. Lowest of all ratings is used for the purposes of this table for securities rated by two or more nationally recognized statistical rating organizations.

2. This table does not include ML's commercial and residential mortgage loans, swaps, and other derivative contracts.

3. Includes all asset sectors that, individually, represent less than five percent of aggregate fair value of debt securities.

ii. Commercial and Residential Mortgage Loans

Commercial and residential mortgage loans are subject to a high degree of credit risk because of exposure to loss from loan defaults. Default rates are subject to a wide variety of factors, including, but not limited to, property performance, property management, supply and demand, construction trends, consumer behavior, regional economic conditions, interest rates, and others.

The performance profile for the commercial and residential mortgage loans at December 31, 2009 was as follows (in millions):

	Remaining principal amount outstanding	Fair value	Fair value as a percentage of remaining principal
Performing loans:			
Commercial	$7,037	$3,879	55.1%
Residential	747	378	50.6%
Subtotal	7,784	4,257	54.7%
Non-performing loans (past due more than 90 days)[1]			
Commercial	1,081	146	13.5%
Residential	739	205	27.7%
Subtotal	1,820	351	19.3%
Total			
Commercial	8,118	4,025	49.6%
Residential	1,486	583	39.2%
Total loans	$9,604	$4,608	48.0%

1. In 2009 ML changed its classification of non-performing/nonaccrual loans to include loans with payments past due greater than 90 days or when ML has doubts about the future performance of the loan assets. The prior year classification included all loans greater than 60 days past due. This change in presentation was made to conform to industry standards and did not have a material effect on ML's consolidated financial statements.

The following table summarizes the state in which residential mortgage loans are collateralized and the property types of the commercial mortgage loans held in the ML portfolio at December 31, 2009:

	Concentration of unpaid principal balances	
	Residential	Commercial[2]
By State:		
California	36.4%	
Florida	9.1%	
Other[1]	54.5%	
	100.0%	
By Property:		
Hospitality		82.8%
Office		9.1%
Other[1]		8.1%
		100.0%

1. No other individual state or property type comprises more than five percent of the total.
2. One borrower represents approximately 50 percent of total unpaid principal balance of the commercial mortgage loan portfolio.

iii. Derivative Instruments

Derivative contracts are instruments, such as futures or swap contracts, which derive their value from underlying assets, indices, reference rates, or a combination of these factors. The ML portfolio includes various derivative financial instruments, primarily consisting of a total return swap agreement ("TRS") with JPMC. ML and JPMC entered into the TRS with reference obligations representing single-named credit default swaps ("CDS") primarily on ABS and interest rate swaps ("IRS") with various market participants, including JPMC. ML, through its Investment Manager, currently manages the CDS contracts within the TRS as a runoff portfolio and may unwind, amend, or novate reference obligations on an ongoing basis.

On an ongoing basis, per the terms of the TRS, ML pledges collateral for credit or liquidity related shortfalls based on 20 percent of the notional amount of sold CDS protection and 10 percent of the present value of future premiums on purchased CDS protection. Separately, ML and JPMC engage in bilateral posting of collateral to cover the net mark-to-market ("MTM") variations in the swap portfolio. ML only nets the collateral received from JPMC from the bilateral MTM posting for the reference obligations where JPMC is the counterparty. The values of ML's cash equivalents and investments, purchased by the re-hypothecation of cash collateral associated with the TRS, were $0.8 billion and $0.5 billion, respectively, as of December 31, 2009 and $2.1 billion and $0.5 billion, respectively, as of December 31, 2008. In addition, ML has pledged $1.5 billion and $3.0 billion of federal agency and GSE MBS to JPMC as of December 31, 2009 and 2008, respectively.

ML enters into additional derivative contracts consisting of futures and interest rate swaps to economically hedge its exposure to interest rates. All derivatives are recorded at fair value in accordance with ASC 815. None of the derivatives held in ML are designated as hedging instruments for accounting purposes.

The following risks are associated with the derivative instruments within ML as part of the TRS agreement with JPMC as well as any derivatives outside of the TRS:

Market Risk

IRS obligate two parties to exchange one or more payments typically calculated with reference to fixed or periodically reset rates of interest applied to a specified notional principal amount. Notional principal is the amount to which interest rates are applied to determine the payment streams under IRS. Such notional principal amounts often are used to express the volume of these transactions but are not actually exchanged between the counterparties.

Futures contracts are agreements to buy and sell financial instruments for a set price on a future date. Initial margin deposits are made upon entering into futures contracts in the form of cash or securities. During the period that a futures contract is open, changes in the value of the contract are recorded as unrealized gains or losses by revaluing the contracts on a daily basis to reflect the market value of the contract at the end of each day's trading. Variation margin payments are paid or received, depending upon whether unrealized gains or losses result. When the contract is closed, ML will record a realized gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and ML's cost basis in the contract. The use of futures transactions involves the risk of imperfect correlation in movements in the price of futures contracts, interest rates and the underlying hedged assets. ML is also at risk of not being able to enter into a closing transaction for the futures contract because of an illiquid secondary market. ML had pledged collateral related to future contracts of $40 million and $69 million as of December 31, 2009 and 2008, respectively.

CDS are agreements that provide protection for the buyer against the loss of principal on a bond or loan in case of a default by the issuer. The nature of a credit event is established by the protection buyer and protection seller at the inception of a transaction, and such events include bankruptcy, insolvency or failure to meet payment obligations when due. The buyer of the CDS pays a premium in return for payment protection upon the occurrence, if any, of a credit event. Upon the occurrence of a triggering credit event, the maximum potential amount of future payments the seller could be required to make under a CDS is equal to the notional amount of the contract. Such future payments could be reduced or offset by amounts recovered under recourse or by collateral provisions outlined in the contract, including seizure and liquidation of collateral pledged by the buyer. ML's derivatives portfolio consists of purchased credit protection with underlying referenced names not correlated to offset its exposure to sold credit protection.

Credit Risk

Credit risk is the risk of financial loss resulting from failure by a counterparty to meet its contractual obligations to ML. This can be caused by factors directly related to the counterparty, such as business or management. Taking collateral is the most common way to mitigate credit risk. ML takes financial collateral in the form of cash and marketable securities as part of the TRS agreement with JPMC as well as the over-the-counter derivatives activities outside of the TRS.

The following table summarizes the notional amounts of derivative instruments by contract type outstanding as of December 31, 2009 and 2008 (in millions):

	Notional Amounts[1,2]	
	2009	2008
Interest rate contracts:		
IRS	$ 3,185	$11,188
Futures and options on futures[3]	70	45
Credit derivatives:		
CDS	7,323	11,791
Total	$10,578	$23,024

1. Represents the sum of gross long and gross short notional derivative contracts.
2. There were 1,764 and 3,606 CDS and IRS contracts outstanding as of December 31, 2009 and 2008, respectively.
3. Futures and options on futures related to contract obligations and not gross notional amounts.

The following table summarizes the fair value of derivative instruments by contract type on a gross basis as of December 31, 2009 (in millions):

	Derivatives used in trading activities	
	Gross derivative assets	Gross derivative liabilities
Interest rate contracts:		
Swaps	$ 5	$ 195
Futures	20	-
Credit derivatives:		
CDS	3,271	1,816
Counterparty netting	(1,868)	(1,868)
Cash collateral	(281)	-
Total	$ 1,147	$ 143

The table below summarizes certain information regarding protection sold through CDS as of December 31, 2009 (in millions):

Credit Ratings of the Reference Obligation	Maximum Potential Payout / Notional — Years to Maturity: Up to 1 year	1–3	3–5	Over 5	Total	Fair Value Liability
Investment grade (AAA to BBB-)	$40	$140	$ 5	$ 165	$ 350	$ 154
Non-investment grade	5	20	120	1,954	2,099	1,640
Total credit default swaps sold	$45	$160	$125	$2,119	$2,449	$1,794

(d) Maiden Lane II LLC

ML II's investments in non-agency RMBS expose ML II to varying levels of credit, interest rate, general market, and concentration risk. Credit-related risk on non-agency RMBS arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the non-agency RMBS are issued. The rate of delinquencies and defaults on residential mortgage loans and the aggregate amount of the resulting losses can be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower.

The rate of interest payable on certain non-agency RMBS may be set or effectively capped at the weighted average net coupon of the underlying mortgage loans, often referred to as an available funds cap. As a result of this available funds cap, the return to the holder of such non-agency RMBS is dependent on the relative timing and rate of delinquencies and prepayments of mortgage loans bearing a higher rate of interest.

At December 31, 2009, the type/sector and rating composition of ML II's $15,643 million non-agency RMBS portfolio, recorded at fair value, as a percentage of aggregate fair value, was as follows:

	Rating[1,3]					
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and lower	Total
Asset Type:						
Alt-A ARM	0.9%	3.1%	2.2%	1.9%	23.3%	31.3%
Subprime	7.7%	2.8%	3.0%	1.9%	39.4%	54.8%
Option ARM	0.0%	0.0%	0.0%	0.1%	6.0%	6.1%
Other[2]	0.1%	0.6%	0.0%	0.0%	7.2%	7.8%
Total	8.7%	6.4%	5.2%	3.8%	75.9%	100.0%

1. Lowest of all ratings is used for the purposes of this table if rated by two or more nationally recognized statistical rating organizations.

2. Includes all asset types that, individually, represent less than five percent of aggregate outstanding fair value of debt securities.

3. Rows and columns may not total due to rounding.

At December 31, 2009, approximately 44 percent of the properties collateralizing the non-agency RMBS held by ML II were located in California and Florida based on the geographic location data available for the underlying loans by aggregate unpaid principal balance.

(e) Maiden Lane III LLC

The primary holdings within ML III are ABS CDOs. An ABS CDO is a security issued by a bankruptcy remote entity that is backed by a diversified pool of debt securities, which in the case of ML III are primarily RMBS and CMBS. The cash flows of ABS CDOs can be split into multiple segments, called "tranches," which vary in risk profile and yield. The junior tranches bear the initial risk of loss, followed by the more senior tranches. The ABS CDOs in the ML III portfolio largely represent senior tranches. Because they are shielded from defaults by the subordinated tranches, senior tranches typically have higher credit ratings and lower yields than the underlying securities, and will often receive investment-grade ratings from one or more of the nationally recognized rating agencies. Despite the protection afforded by the subordinated tranches, senior tranches can experience substantial losses from actual defaults on the underlying non-agency RMBS or CMBS.

ABS CDO securities are limited recourse obligations of the issuer thereof payable solely from the underlying securities owned by the issuer or proceeds thereof. Consequently, holders of ABS CDO securities must rely solely on distributions on the collateral underlying such ABS CDO securities or the proceeds thereof for payment. Such collateral may consist of investment-grade debt securities, high-yield debt securities, loans, structured finance securities, synthetic securities and other debt instruments. Investments in assets through the purchase of synthetic securities present risks in addition to those resulting from direct purchases of those assets because the buyer of such synthetic security usually will have a contractual relationship only with the synthetic security counterparty and not the obligor on the reference obligation of such synthetic security. The buyer of a synthetic security will not benefit from any collateral supporting the reference obligation of such synthetic security, will not have any remedies that would normally be available to the holder of such reference obligation, and will be subject to the credit risk of the synthetic security counterparty as well as the obligor on such reference obligation. Over the last several years, there has been a significant increase in the default rates of, delinquencies on, and rating downgrades reported on RMBS and CMBS. As a result of increases in the default rates and delinquencies, there has been a decrease in the amount of credit support available for the ABS CDO securities backed by such RMBS and CMBS since the issue date thereof. Diminished credit support as a result of increases in the default rates of, delinquencies on, and rating downgrades reported on RMBS and CMBS could increase the likelihood that payments may not be made to holders of ABS CDO securities.

Certain ABS CDO issuers can issue short-term eligible investments under Rule 2a-7 of the Investment Company Act of 1940 if the ABS CDO contains arrangements to remarket the securities at defined periods. The investments must contain put options ("2a-7 Puts") which allow the purchasers to sell the ABS CDO at par to a third-party ("Put Provider"), if a scheduled remarketing is unsuccessful due to reasons other than a credit or bankruptcy event. As of December 31, 2009, the total notional value of ABS CDOs held by ML III with embedded 2a-7 Puts, for which AIGFP was, directly or indirectly, the Put Provider, was $1.6 billion. ML III has entered into an agreement not to exercise the 2a-7 Puts, or to only exercise the 2a-7 Puts if it simultaneously repurchases the ABS CDOs at par. In return, ML III will receive the put premiums and AIGFP will take the necessary steps to attempt conversion of the ABS CDOs to long-term notes. The termination dates of this agreement range from December 31, 2010 to April 30, 2011 depending on the respective ABS CDOs.

CMBS and RMBS expose ML III to varying levels of credit, interest rate, liquidity, and concentration risk. Credit-related risk arises from losses due to delinquencies and defaults by borrowers on the underlying mortgage loans and breaches by originators and servicers of their obligations under the underlying documentation pursuant to which the securities are issued. The rate of delinquencies and defaults on residential and commercial mortgage loans and the aggregate amount of the resulting losses can be affected by a number of factors, including general economic conditions, particularly those in the area where the related mortgaged property is located; the level of the borrower's equity in the mortgaged property; and the individual financial circumstances of the borrower.

At December 31, 2009, the investment type/vintage and rating composition of ML III's $22,339 million portfolio, recorded at fair value, as a percentage of aggregate fair value of all securities in the portfolio was as follows:

	Rating[1,2,3]						
	AAA	AA+ to AA-	A+ to A-	BBB+ to BBB-	BB+ and Lower	Not Rated	Total
ABS CDOs:							
High-Grade ABS CDOs	0.0%	0.0%	0.0%	0.0%	68.9%	0.0%	68.9%
Pre-2005	0.0%	0.0%	0.0%	0.0%	24.3%	0.0%	24.3%
2005	0.0%	0.0%	0.0%	0.0%	30.6%	0.0%	30.6%
2006	0.0%	0.0%	0.0%	0.0%	7.3%	0.0%	7.3%
2007	0.0%	0.0%	0.0%	0.0%	6.7%	0.0%	6.7%
Mezzanine ABS CDOs	0.0%	0.2%	0.0%	0.5%	8.0%	0.3%	8.9%
Pre-2005	0.0%	0.2%	0.0%	0.5%	4.4%	0.3%	5.4%
2005	0.0%	0.0%	0.0%	0.0%	2.8%	0.0%	2.8%
2006	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2007	0.0%	0.0%	0.0%	0.0%	0.7%	0.0%	0.7%
Commercial Real-Estate CDOs	1.5%	0.5%	18.9%	0.0%	0.0%	0.0%	21.0%
Pre-2005	1.5%	0.5%	3.1%	0.0%	0.0%	0.0%	5.2%
2005	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2006	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
2007	0.0%	0.0%	15.8%	0.0%	0.0%	0.0%	15.8%
RMBS, CMBS, & Other:	0.2%	0.2%	0.1%	0.1%	0.6%	0.0%	1.2%
Pre-2005	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.2%
2005	0.1%	0.1%	0.1%	0.1%	0.4%	0.0%	0.9%
2006	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	0.1%
2007	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Total Investments	1.7%	0.8%	19.1%	0.6%	77.5%	0.3%	100.0%

1. Lowest of all ratings is used for the purposes of this table if rated by two or more nationally recognized statistical rating organizations.
2. The year of issuance with the highest concentration of underlying assets as measured by outstanding principal balance determines the vintage of the CDO.
3. Rows and columns may not total due to rounding

(f) TALF LLC

TALF loans are extended on a non-recourse basis by the FRBNY. If the borrower does not repay the loan, the FRBNY will enforce its rights in the collateral and may sell the collateral, pursuant to a put agreement, to TALF LLC, established for the purpose of purchasing such assets. As of December 31, 2009 the FRBNY did not enforce its rights to the TALF loan collateral or exercise the put option. As a result, TALF LLC did not purchase any assets from the FRBNY.

Cash receipts resulting from the put option fees paid to the TALF LLC and proceeds from the Treasury's subordinated loan are invested in the following types of U.S. dollar-denominated short-term investments and cash equivalents eligible for purchase by the TALF LLC: (1) Treasury securities, (2) federal agency securities that are senior, negotiable debt obligations of the Federal National Mortgage Association ("FNMA"), Federal Home Loan Mortgage Corporation ("FHLMC"), Federal Home Loan Banks ("FHLB"), and Federal Farm Credit Banks ("FFCB") which have a fixed rate of interest, (3) repurchase agreements that are collateralized by Treasury and federal agency securities and fixed-rate agency MBS, and (4) money market mutual funds registered with the Securities and Exchange Commission and regulated under Rule 2a-7 of the Investment Company Act that invest exclusively in Treasury and federal agency securities.

(g) Fair-Value Measurement

The consolidated VIEs have adopted ASC 820 and ASC 825 and have elected the fair value option for all securities and commercial and residential mortgages held by ML and TALF LLC. ML II and ML III qualify as nonregistered investment companies under the provisions of ASC 946 and, therefore, all investments are recorded at fair value in accordance with ASC 820. In addition, the FRBNY has elected to record the beneficial interests in ML, ML II, ML III, and the TALF LLC at fair value.

The accounting and classification of these investments appropriately reflects the VIEs' and the FRBNY's intent with respect to the purpose of the investments and most closely reflects the amount of the assets available to liquidate the entities' obligations.

i. Fair Value Hierarchy

ASC 820 establishes a three-level fair value hierarchy that distinguishes between market participant assumptions developed using market data obtained from independent sources (observable inputs) and the consolidated VIEs assumptions about market participant assumptions developed using the best information available in the circumstances (unobservable inputs).

The three levels established by ASC 820 are described below:

- Level 1 — Valuation is based on quoted prices for identical instruments traded in active markets.
- Level 2 — Valuation is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 — Valuation is based on inputs from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the consolidated VIE's estimates of assumptions that market participants would use in pricing the asset and liability. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques.

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

ii. Determination of Fair Value

The consolidated VIEs value their investments on the basis of the last available bid prices or current market quotations provided by dealers, or pricing services selected by their designated investment managers. To determine the value of a particular investment, pricing services may use information on transactions in such investments; quotations from dealers; pricing metrics; market transactions in comparable investments; relationships observed in the market between investments; and calculated yield measures based on valuation methodologies commonly employed in the market for such investments.

Market quotations may not represent fair value in circumstances in which the investment manager believes that facts and circumstances applicable to an issuer, a seller, a purchaser, or the market for a particular security result in the current market quotations reflecting an inaccurate fair value of the security. To determine fair value, the investment manager applies proprietary valuation models that use collateral performance scenarios and pricing metrics derived from the reported performance of the universe of bonds with similar characteristics as well as the observable market.

Because of the inherent uncertainty of determining the fair value of investments that do not have a readily available fair value, the fair value of these investments may differ significantly from the values that would have been reported if a readily available fair value had existed for these investments and may differ materially from the values that may ultimately be realized.

The fair value of the liability for the beneficial interests of consolidated VIEs is estimated based upon the fair value of the underlying assets held by the VIEs. The holders of these beneficial interests do not have recourse to the general credit of the FRBNY.

iii. Valuation Methodologies for Level 3 Assets and Liabilities

In certain cases where there is limited activity around inputs to the valuation, securities are classified within level 3 of the valuation hierarchy. For example, in valuing CDOs, certain collateralized mortgage obligations, and commercial and residential mortgage loans, the determination of fair value is based on collateral performance scenarios. These valuations also incorporate pricing metrics derived from the reported performance of the universe of bonds as well as observations and estimates of market data. Because external price information is not available, market-based models are used to value these securities. Key inputs to the model are market spreads, data for each credit rating, collateral type, and other relevant contractual features. Because there is lack of observable pricing, securities and investment loans that are carried at fair value are classified within level 3.

The following tables present the financial instruments recorded in VIEs at fair value as of December 31 by ASC 820 hierarchy (in millions):

	2009				
	Level 1	Level 2	Level 3	Netting[1]	Total fair value
Assets:					
Cash equivalents	$1,933	$ 142	$ -	$ -	$ 2,075
CDOs	-	241	22,409	-	22,650
Non-agency RMBS	-	9,461	8,091	-	17,552
Federal agency and GSE MBS	-	18,125	24	-	18,149
Commercial mortgage loans	-	-	4,025	-	4,025
Residential mortgage loans	-	-	583	-	583
Swap contracts	-	5	3,272	(2,150)	1,127
Other investments	31	5,413	23	-	5,467
Other assets	20	-	-	-	20
Total assets	$1,984	$33,387	$38,427	$(2,150)	$71,648
Liabilities:					
Beneficial interest in consolidated VIEs	$ -	$ -	$ 5,095	$ -	$ 5,095
Swap contracts	-	195	1,816	(1,868)	143
Total liabilities	$ -	$ 195	$ 6,911	$(1,868)	$ 5,238

1. Derivative receivables and payables and the related cash collateral received and paid are shown netted when a master netting agreement exists.

	2008			
	Level 1	Level 2	Level 3	Total fair value
Assets:				
CDOs	$-	$ 155	$26,802	$26,957
Non-agency RMBS	-	8,165	12,510	20,675
Federal agency and GSE MBS	-	14,759	895	15,654
Commercial mortgage loans	-	-	5,553	5,553
Residential mortgage loans	-	-	937	937
Swap contracts	-	-	2,454	2,454
Other investments	-	1,992	348	2,340
Total assets	$-	$25,071	$49,499	$74,570
Liabilities:				
Beneficial interest in consolidated variable interest entities	$-	$ -	$ 2,824	$ 2,824

The tables below present a reconciliation of all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (level 3) at December 31, 2009 and 2008. Unrealized gains and losses related to those assets still held at December 31, 2009 and 2008 are reported as a component of "Consolidated variable interest entities: Investments held by consolidated variable interest entities, net" in the Combined Statements of Condition.

	2009					
	Fair value January 1	Net purchases, sales, and settlements	Total realized/ unrealized gains (losses)	Net transfers in or out	Fair value December 31	Change in unrealized gains/(losses) related to financial instruments held at December 31, 2009
Assets:						
CDOs	$26,802	$(3,123)	$(1,267)	$ (3)	$22,409	$(1,265)
Non-agency RMBS	12,510	(1,481)	(499)	(2,439)	8,091	(533)
Federal agency and GSE MBS	895	(248)	-	(623)	24	-
Commercial mortgage loans	5,553	(305)	(1,223)	-	4,025	(1,177)
Residential mortgage loans	937	(86)	(268)	-	583	(219)
Other investments	348	(263)	30	(92)	23	29
Total assets	$47,045	$(5,506)	$(3,327)	$(3,157)	$35,155	$(3,165)
Net swap contracts[2]	2,454	(906)	94	(186)	1,456	212
Liabilities:						
Beneficial interest in consolidated variable interest entities	$ (2,824)	$ (368)[1]	$(1,903)	$ -	$ (5,095)	$(1,903)

1. Includes $268 million in capitalized interest.
2. Level 3 derivative assets and liabilities are presented net for the purposes of this table.

	2008					
	Fair value January 1	Net purchases, sales, and settlements	Total realized/ unrealized gains (losses)	Net transfers in or out	Fair value December 31	Change in unrealized gains/(losses) related to financial instruments held at December 31, 2008
Assets:						
CDOs	$-	$29,740	$(2,938)	$-	$26,802	$(2,938)
Non-agency RMBS	-	14,668	(2,158)	-	12,510	(2,159)
Federal agency and GSE MBS	-	891	4	-	895	4
Commercial mortgage loans	-	7,683	(2,130)	-	5,553	(2,130)
Residential mortgage loans	-	1,500	(563)	-	937	(563)
Swap contracts	-	2,369	85	-	2,454	155
Other investments	-	625	(277)	-	348	(278)
Total assets	$-	$57,476	$(7,977)	$-	$49,499	$(7,909)
Liabilities:						
Beneficial interest in consolidated variable interest entities	$-	$ (7,213)[1]	$ 4,389	$-	$ (2,824)	$ 4,389

1. Includes $63 million in capitalized interest.

(h) Professional Fees

The consolidated VIEs have recorded costs for professional services provided by several nationally recognized institutions to serve as investment managers, administrators, and custodians for the VIEs' assets. The fees charged by the investment managers, custodians, and administrators, as well as the auditors, attorneys, and other service providers, are recorded in "Professional fees related to consolidated variable interest entities" in the Combined Statements of Income and Comprehensive Income.

(10) Non-Consolidated Variable Interest Entities

In December 2009, the FRBNY obtained preferred securities in two VIEs. The FRBNY does not consolidate these VIEs because it does not have a controlling financial interest. The FRBNY's maximum exposure to any potential losses of the VIEs, should they occur, is limited to the recorded value of the FRBNY's investment in the preferred securities and dividends receivable from the VIE. The following table shows the financial information related to nonconsolidated VIEs for the year ended December 31, 2009 (in millions):

	AIA LLC	ALICO LLC	Total Non-Consolidated VIEs
Total assets	$89,100	$114,800	$203,900
Total liabilities	73,600	100,800	174,400
Maximum exposure to loss	16,068	9,038	25,106

The recorded value of the FRBNY's investment in the preferred securities, including capitalized dividends, was $16,068 million for AIA LLC and $9,038 million for ALICO LLC at December 31, 2009. The FRBNY's investment in preferred securities and capitalized dividends is reported as "Preferred securities" and dividends receivable are reported as a component of "Other assets" in the Combined Statements of Condition.

The fair value of the FRBNY's preferred interests in AIA LLC and ALICO LLC was not materially different from the amount reported as "Preferred securities" in the Combined Statements of Condition as of December, 31, 2009.

(11) Bank Premises, Equipment, And Software

Bank premises and equipment at December 31 were as follows (in millions):

	2009	2008
Bank premises and equipment:		
Land	$ 344	$ 334
Buildings	2,378	2,161
Building machinery and equipment	492	463
Construction in progress	43	160
Furniture and equipment	1,010	1,037
Subtotal	4,267	4,155
Accumulated depreciation	(1,643)	(1,583)
Bank premises and equipment, net	$ 2,624	$ 2,572
Depreciation expense, for the years ended December 31	$ 202	$ 199

Bank premises and equipment at December 31 included the following amounts for capitalized leases (in millions):

	2009	2008
Leased premises and equipment under capital leases	$10	$ 21
Accumulated depreciation	(6)	(13)
Leased premises and equipment under capital leases, net	$ 4	$ 8
Depreciation expense related to leased premises and equipment under capital leases	$ 2	$ 4

The Reserve Banks lease space to outside tenants with remaining lease terms ranging from one to fifteen years. Rental income from such leases was $32 million and $30 million for the years ended December 31, 2009 and 2008, respectively, and is reported as a component of “Other income” in the Combined Statements of Income and Comprehensive Income. Future minimum lease payments that the Reserve Banks will receive under noncancelable lease agreements in existence at December 31, 2009 were as follows (in millions):

2010	$ 28
2011	24
2012	21
2013	20
2014	19
Thereafter	54
Total	$166

The Reserve Banks had capitalized software assets, net of amortization, of $134 million and $129 million at December 31, 2009 and 2008, respectively. Amortization expense was $52 million and $67 million for the years ended December 31, 2009 and 2008, respectively. Capitalized software assets are reported as a component of “Other assets” in the Combined Statements of Condition and the related amortization is reported as a component of “Other expenses” in the Combined Statements of Income and Comprehensive Income.

Assets impaired as a result of the Reserve Banks’ restructuring plans, as discussed in Note 16, include check equipment, leasehold improvements, and furniture assets. Asset impairment losses of $2 million for the year ended December 31, 2008 were determined using fair values based on quoted fair values or other valuation techniques and are reported as a component of “Operating expenses: Other expenses” in the Combined Statements of Income and Comprehensive Income. There were no asset impairments for the year ended December 31, 2009.

(12) Commitments And Contingencies

In the normal course of operations the Reserve Banks enter into contractual commitments, normally with fixed expiration dates or termination provisions, at specific rates and for specific purposes.

At December 31, 2009, the Reserve Banks were obligated under noncancelable leases for premises and equipment with remaining terms ranging from one to approximately 14 years. These leases provide for increased rental payments based upon increases in real estate taxes, operating costs, or selected price indices.

Rental expense under operating leases for certain operating facilities, warehouses, and data processing and office equipment (including taxes, insurance, and maintenance when included in rent), net of sublease rentals, was $27 million for each of the years ended December 31, 2009 and 2008.

Future minimum rental payments under noncancelable operating leases, net of sublease rentals, with remaining terms of one year or more, at December 31, 2009 are as follows (in millions):

	Operating leases
2010	$ 11
2011	12
2012	12
2013	11
2014	11
Thereafter	95
Future minimum rental payments	$ 152

At December 31, 2009, the Reserve Banks had unrecorded unconditional purchase commitments and long-term obligations extending through the year 2017 with a remaining fixed commitment of $206 million. Purchases of $28 million and $33 million were made against these commitments during 2009 and 2008, respectively. These commitments represent maintenance of currency processing machines and have variable and/or fixed components. The variable portion of the commitments is for additional services above fixed contractual service limits. The fixed payments for the next five years under these commitments are as follows (in millions):

2010	$32
2011	23
2012	23
2013	24
2014	25

The Reserve Banks are involved in certain legal actions and claims arising in the ordinary course of business. Although it is difficult to predict the ultimate outcome of these actions, in management's opinion, based on discussions with counsel, the aforementioned litigation and claims will be resolved without material adverse effect on the financial position or results of operations of the Reserve Banks.

Other Commitments

In support of financial market stability activities, the Reserve Banks entered into commitments to provide financial assistance and backstop support to financial institutions. The contractual amount represents the Reserve Banks' maximum exposure to loss in the event that the commitments are fully funded and there is a default by the borrower or total loss in value of pledged collateral. Total commitments at December 31, 2009 and 2008 were as follows (in millions):

	2009		2008	
	Contractual amount	Unfunded amount	Contractual amount	Unfunded amount
Loan commitment (Citigroup)	$ -	$ -	$244,800	$244,800
Secured line of credit (AIG)	35,000	17,100	60,000	23,200
Commercial loan commitments (ML)	157	157	266	266
Total	$35,157	$17,257	$305,066	$268,266

The agreement with Citigroup, while legally a loan commitment, is accounted for in accordance with FASB ASC Topic 460 (ASC 460), Guarantees (previously FIN 45). This agreement was terminated effective December 23, 2009 and, as a result, the FRBNY had no contractual obligation at December 31, 2009. The termination fee of $50 million is reported as a component of "Other income" in the Combined Statements of Income.

The secured line of credit relates to the undrawn portion of the FRBNY's commitment to lend to AIG. The amount of the FRBNY's commitment to lend to AIG was reduced during the year ended December 31, 2009 as a result of the debt restructuring described in Note 3, Note 4, and Note 5. Collateral to secure the FRBNY's loan to AIG includes the equity in AIG's subsidiaries. The FRBNY does not expect to incur any losses related to the unfunded commitment as of December 31, 2009.

The undrawn portion of the FRBNY's commercial loan commitment relates to commercial mortgage loans acquired by ML.

(13) Retirement And Thrift Plans

Retirement Plans

The Reserve Banks currently offer three defined benefit retirement plans to their employees, based on length of service and level of compensation. Substantially all of the employees of the Reserve Banks, Board of Governors, and Office of Employee Benefits of the Federal Reserve System ("OEB") participate in the Retirement Plan for Employees of the Federal Reserve System ("System Plan"). In addition, employees at certain compensation levels participate in the Benefit Equalization Retirement Plan ("BEP") and certain Reserve Bank officers participate in the Supplemental Retirement Plan for Select Officers of the Federal Reserve Bank ("SERP").

The System Plan provides retirement benefits to employees of the Federal Reserve Banks, the Board of Governors, and OEB. The FRBNY, on behalf of the System, recognizes the net asset or net liability and costs associated with the System Plan in its consolidated financial statements. Costs associated with the System Plan are not reimbursed by other participating employers.

Following is a reconciliation of the beginning and ending balances of the System Plan benefit obligation (in millions):

	2009	2008
Estimated actuarial present value of projected benefit obligation at January 1	$7,031	$5,325
Service cost-benefits earned during the period	204	150
Interest cost on projected benefit obligation	427	357
Actuarial (gain) loss	(28)	599
Contributions by plan participants	3	3
Special termination benefits	9	9
Benefits paid	(291)	(280)
Plan amendments	9	868
Estimated actuarial present value of projected benefit obligation at December 31	$7,364	$7,031

Following is a reconciliation showing the beginning and ending balance of the System Plan assets, the funded status, and the accrued pension benefit costs (in millions):

	2009	2008
Estimated plan assets at January 1 (of which $5,037 million and $6,566 million is measured at fair value as of January 1, 2009 and 2008, respectively)	$ 5,053	$ 6,604
Actual return on plan assets	1,016	(1,274)
Contributions by the employer	500	-
Contributions by plan participants	3	3
Benefits paid	(291)	(280)
Estimated plan assets at December 31 (of which $6,252 million and $5,037 million is measured at fair value as of December 31, 2009 and 2008, respectively)	$ 6,281	$ 5,053
Funded status and accrued pension benefit costs	$(1,083)	$(1,978)
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ (883)	$ (989)
Net actuarial loss	(2,488)	(3,429)
Total accumulated other comprehensive loss	$(3,371)	$(4,418)

Accrued pension benefit costs are reported as "Accrued benefit costs" in the Combined Statements of Condition.

The accumulated benefit obligation for the System Plan, which differs from the estimated actuarial present value of projected benefit obligation because it is based on current rather than future compensation levels, was $6,430 million and $6,143 million at December 31, 2009 and 2008, respectively.

The weighted-average assumptions used in developing the accumulated and projected pension benefit obligations for the System Plan as of December 31 were as follows:

	2009	2008
Discount rate	6.00%	6.00%
Rate of compensation increase	5.00%	5.00%

Net periodic benefit expenses for the years ended December 31, 2009 and 2008 were actuarially determined using a January 1 measurement date. In 2008, several amendments were made to the plan. As a result, the actuarially determined net periodic benefit expenses for the year ended December 31, 2008 were remeasured as of November 1, 2008 using a 7.75% discount rate. The plan amendments, the most significant of which was to incorporate annual, rather than ad-hoc, cost-of-living adjustments to the participants' plan benefit, resulted in a $60 million increase in net periodic benefit expenses for the year ended December 31, 2008. There were no significant benefit changes approved in 2009.

The weighted-average assumptions used in developing net periodic benefit expenses for the System Plan for the years were as follows:

	2009	2008
Discount rate	6.00%	6.50%
Expected asset return	7.75%	8.00%
Rate of compensation increase	5.00%	5.00%

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the System Plan's benefits when due. The expected long-term rate of return on assets was based on a combination of factors, including the System Plan's asset allocation strategy and historical returns; surveys of expected rates of return for other entities' plans; a projected return for equities and fixed income investments based on real interest rates, inflation expectations, and equity risk premiums; and surveys of expected returns in equity and fixed income markets.

The components of net periodic pension benefit expense for the System Plan for the years ended December 31 are shown below (in millions):

	2009	2008
Service cost-benefits earned during the period	$ 204	$ 150
Interest cost on accumulated benefit obligation	427	357
Amortization of prior service cost	116	41
Amortization of net loss	285	78
Expected return on plan assets	(389)	(497)
Net periodic pension benefit expense	643	129
Special termination benefits	9	9
Total net periodic pension benefit expense	$ 652	$ 138
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic pension benefit expense in 2010 are shown below:		
Prior service cost	$ 112	
Net actuarial loss	181	
Total	$ 293	

The recognition of special termination benefits is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in Note 16.

Following is a summary of expected benefit payments, excluding enhanced retirement benefits (in millions):

	Expected benefit payments
2010	$ 332
2011	343
2012	364
2013	388
2014	411
2015–2018	2,389
Total	$ 4,227

The System's Committee on Investment Performance ("CIP") is responsible for establishing investment policies, selecting investment managers, and monitoring the investment managers' compliance with the policies. At December 31, 2009, the System Plan's assets were held in six investment vehicles: a constant-mix asset allocation account, a liability-linked account, an indexed U.S. investment-grade bond fund, an indexed U.S. equity fund, a non-U.S. developed-markets fund, and a money market fund. The diversity in investment vehicles is to limit concentration of risk and the risk of loss related to any specific sector. The constant mix account tracks the Standard & Poor's 500 Stock Index and the Barclays Aggregate Bond Index, and is automatically rebalanced. The liability-linked account, funded in April 2008, seeks to defease a portion of the System Plan's liability related to retired lives using a Treasury securities portfolio. The policy governing this account calls for cash-matching the first two years of a portion of retiree benefits payments and immunizing the remaining obligation. The money market fund is the repository for cash balances and adheres to a constant dollar accounting methodology. Permitted and prohibited investments, as well as use of derivatives in the indexed vehicles for which the System Plan's assets are invested, are defined as part of the trust agreement for the selected investment vehicle. The CIP reviews this agreement as part of the selection of each investment to ensure that the trust agreement is consistent with the CIP's investment objectives for the System Plan's assets. In the case of the constant-mix asset allocation account, investments must be within the defined indices and the use of derivatives is permitted to the extent necessary to manage cash flows.

The System Plan's policy and actual asset allocations at December 31, by asset category, are as follows:

	Policy	2009 Actual	2008 Actual
U.S. equities	50.7%	53.0%	55.4%
International equities	11.8%	12.9%	5.9%
Fixed income	37.5%	33.8%	36.9%
Cash	0.0%	0.3%	1.8%
Total	100.0%	100.0%	100.0%

Contributions to the System Plan may be determined using different assumptions than those required for financial reporting. The System Plan's actuarial funding method is expected to produce a recommended annual funding range between $400 and $450 million. In 2010, the System will make monthly contributions of $35 million and will reevaluate upon completion of the 2010 actuarial valuation. The Reserve Banks' projected benefit obligation, funded status, and net pension expenses for the BEP and the SERP at December 31, 2009 and 2008, and for the years then ended, were not material.

The System Plan's investments are reported at fair value as required by ASC 820. ASC 820 establishes a three-level fair value hierarchy that distinguishes between market participant assumptions developed using market data obtained from independent sources (observable inputs) and the Reserve Banks' assumptions about market participant assumptions developed using the best information available in the circumstances (unobservable inputs).

The three levels established by ASC 820 are described below:

- Level 1 — Valuation is based on quoted prices for identical instruments traded in active markets.
- Level 2 — Valuation is based on quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.
- Level 3 — Valuation is based on inputs from model-based techniques that use significant assumptions not observable in the market. These unobservable assumptions reflect the Reserve Banks' estimates of assumptions that market participants would use in pricing the asset and liability. Valuation techniques include the use of option pricing models, discounted cash flow models, and similar techniques.

The inputs or methodology used for valuing securities are not necessarily an indication of the risk associated with investing in those securities.

The following tables present the financial instruments recorded at fair value as of December 31 by ASC 820 hierarchy (in millions):

	2009			
Description	Level 1	Level 2	Level 3	Total
Short-term investments	$ -	$ 24	$-	$ 24
Treasury and federal agency securities	677	38	-	715
GSE debt securities	-	156	-	156
Other fixed income securities	-	128	-	128
Common stocks	883	-	-	883
Commingled funds	-	4,346	-	4,346
Total	$1,560	$4,692	$-	$6,252

	2008			
Description	Level 1	Level 2	Level 3	Total
Short-term investments	$ 15	$ 119	$-	$ 134
Treasury and federal agency securities	852	109	-	961
GSE debt securities	-	403	-	403
Other fixed income securities	-	482	-	482
Common stocks	1,905	-	-	1,905
Commingled funds	-	1,152	-	1,152
Total	$2,772	$2,265	$-	$5,037

The System Plan enters into futures contracts, traded on regulated exchanges, to manage certain risks and to maintain appropriate market exposure in meeting the investment objectives of the System Plan. The System Plan bears the market risk that arises from any unfavorable changes in the value of the securities or indexes underlying these futures contracts. The use of futures contracts involves, to varying degrees, elements of market risk in excess of the amount recorded in the Combined Statements of Condition. The guidelines established by the CIP further reduces risk by limiting the net futures positions, for most fund managers, to 15 percent of the market value of the advisor's portfolio. No limit has been established on the futures positions of the liability-driven investments, since the fund manager only executes Treasury futures.

At December 31, 2009 and 2008, cash available for futures trading was $1 million and $2 million, respectively. At December 31, 2009, there were $1 million of Treasury securities pledged as collateral. At December 31, 2008, there were no securities pledged as collateral.

Thrift Plan

Employees of the Reserve Banks participate in the defined contribution Thrift Plan for Employees of the Federal Reserve System ("Thrift Plan"). The Reserve Banks match employee contributions based on a specified formula. For the year ended December 31, 2008 and for the first three months of the year ended December 31, 2009, the Reserve Banks matched 80 percent of the first six percent of employee contributions for employees with less than five years of service and 100 percent of the first six percent of employee contributions for employees with five or more years of service. Effective April 1, 2009, the Reserve Banks match 100 percent of the first 6 percent of employee contributions from the date of hire and provide an automatic employer contribution of one percent of eligible pay. The Reserve Banks' Thrift Plan contributions totaled $82 million and $72 million for the years ended December 31, 2009 and 2008, respectively, and are reported as a component of "Salaries and other benefits" in the Combined Statements of Income and Comprehensive Income.

(14) Postretirement Benefits Other Than Retirement Plans And Postemployment Benefits

Postretirement Benefits Other Than Retirement Plans

In addition to the Reserve Banks' retirement plans, employees who have met certain age and length-of-service requirements are eligible for both medical benefits and life insurance coverage during retirement.

The Reserve Banks fund benefits payable under the medical and life insurance plans as due and, accordingly, have no plan assets.

Following is a reconciliation of the beginning and ending balances of the benefit obligation (in millions):

	2009	2008
Accumulated postretirement benefit obligation at January 1	$1,221	$1,121
Service cost benefits earned during the period	40	38
Interest cost on accumulated benefit obligation	74	71
Net actuarial loss	54	54
Curtailment gain	-	(10)
Special termination benefits	1	-
Contributions by plan participants	16	15
Benefits paid	(79)	(72)
Medicare Part D subsidies	5	4
Plan amendments	(8)	-
Accumulated postretirement benefit obligation at December 31	$1,324	$1,221

At December 31, 2009 and 2008, the weighted-average discount rate assumptions used in developing the postretirement benefit obligation were 5.75 percent and 6.00 percent, respectively.

Discount rates reflect yields available on high-quality corporate bonds that would generate the cash flows necessary to pay the plan's benefits when due.

Following is a reconciliation of the beginning and ending balance of the plan assets, the unfunded postretirement benefit obligation, and the accrued postretirement benefit costs (in millions):

	2009	2008
Fair value of plan assets at January 1	$ -	$ -
Contributions by the employer	58	53
Contributions by plan participants	16	15
Benefits paid	(79)	(72)
Medicare Part D subsidies	5	4
Fair value of plan assets at December 31	$ -	$ -
Unfunded obligation and accrued postretirement benefit cost	$1,324	$1,221
Amounts included in accumulated other comprehensive loss are shown below:		
Prior service cost	$ 33	$ 44
Net actuarial loss	(338)	(313)
Deferred curtailment gain	-	4
Total accumulated other comprehensive loss	$ (305)	$ (265)

Accrued postretirement benefit costs are reported as a component of "Accrued benefit costs" in the Combined Statements of Condition.

For measurement purposes, the assumed health care cost trend rates at December 31 are as follows:

	2009	2008
Health care cost trend rate assumed for next year	7.50%	7.50%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	5.00%	5.00%
Year that the rate reaches the ultimate trend rate	2015	2014

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects for the year ended December 31, 2009 (in millions):

	One percentage point increase	One percentage point decrease
Effect on aggregate of service and interest cost components of net periodic postretirement benefit costs	$ 15	$ (13)
Effect on accumulated postretirement benefit obligation	135	(115)

The following is a summary of the components of net periodic postretirement benefit expense for the years ended December 31 (in millions):

	2009	2008
Service cost for benefits earned during the period	$ 40	$ 38
Interest cost on accumulated benefit obligation	74	71
Amortization of prior service cost	(20)	(20)
Amortization of net actuarial loss	29	27
Total periodic expense	123	116
Curtailment gain	(4)	(1)
Special termination benefits loss	1	-
Net periodic postretirement benefit expense	$120	$115
Estimated amounts that will be amortized from accumulated other comprehensive loss into net periodic postretirement benefit expense in 2010 are shown below:		
Prior service cost	$ (18)	
Net actuarial loss	29	
Total	$ 11	

Net postretirement benefit costs are actuarially determined using a January 1 measurement date. At January 1, 2009 and 2008, the weighted-average discount rate assumptions used to determine net periodic postretirement benefit expense were 6.00 percent and 6.25 percent, respectively.

Net periodic postretirement benefit expense is reported as a component of "Salaries and other benefits" in the Combined Statements of Income and Comprehensive Income.

The recognition of special termination benefits is primarily the result of enhanced retirement benefits provided to employees during the restructuring described in Note 16. A net curtailment gain associated with restructuring programs that are described in Note 16 was recognized in net income in the year ended December 31, 2009, related to employees who terminated employment during 2009. A deferred curtailment gain was recorded in 2008 as a component of accumulated other comprehensive loss; the gain is recognized in net income in 2009 and future years when the related employees terminate employment.

The Medicare Prescription Drug, Improvement and Modernization Act of 2003 established a prescription drug benefit under Medicare ("Medicare Part D") and a federal subsidy to sponsors of retiree health care benefit plans that provide benefits that are at least actuarially equivalent to Medicare Part D. The benefits provided under the Reserve Banks' plan to certain participants are at least actuarially equivalent to the Medicare Part D prescription drug benefit. The estimated effects of the subsidy are reflected in actuarial loss in the accumulated postretirement benefit obligation and net periodic postretirement benefit expense.

Federal Medicare Part D subsidy receipts were $6.4 million and $3.3 million in the years ended December 31, 2009 and 2008, respectively. Expected receipts in 2010, related to benefits paid in the years ended December 31, 2009 and 2008, are $1 million.

Following is a summary of expected postretirement benefit payments (in millions):

	Without subsidy	With subsidy
2010	$ 76	$ 70
2011	82	76
2012	87	80
2013	92	85
2014	97	88
2015–2019	548	494
Total	$982	$893

Postemployment Benefits

The Reserve Banks offer benefits to former or inactive employees. Postemployment benefit costs are actuarially determined using a December 31 measurement date and include the cost of medical and dental insurance, survivor income, disability benefits, and self-insured workers' compensation expenses. The accrued postemployment benefit costs recognized by the Reserve Banks at December 31, 2009 and 2008, were $153 million and $117 million, respectively. This cost is included as a component of "Accrued benefit costs" in the Combined Statements of Condition. Net periodic postemployment benefit expense included in 2009 and 2008 operating expenses were $56 million and $10 million, respectively, and are recorded as a component of "Salaries and other benefits" in the Combined Statements of Income and Comprehensive Income.

(15) Accumulated Other Comprehensive Income and Other Comprehensive Income

Following is a reconciliation of beginning and ending balances of accumulated other comprehensive income (loss) (in millions):

	Amount related to defined benefit retirement plan	Amount related to postretirement benefits other than retirement plans	Total accumulated other comprehensive income (loss)
Balance at January 1, 2008	$(1,298)	$(226)	$(1,524)
Change in funded status of benefit plans:			
Prior service costs arising during the year	(868)	4	(864)
Net actuarial loss arising during the year	(2,371)	(48)	(2,419)
Deferred curtailment gain	-	1	1
Amortization of prior service cost	41	(20)	21
Amortization of net actuarial loss	78	27	105
Amortization of deferred curtailment gain	-	(3)	(3)
Change in funded status of benefit plans—other comprehensive loss	(3,120)	(39)	(3,159)
Balance at December 31, 2008	$(4,418)	$(265)	$(4,683)
Change in funded status of benefit plans:			
Prior service costs arising during the year	$ (10)	$ 9	$ (1)
Net actuarial gain (loss) arising during the year	656	(54)	602
Amortization of prior service cost	116	(20)	96
Amortization of net actuarial loss	285	29	314
Amortization of deferred curtailment gain	-	(4)	(4)
Change in funded status of benefit plans—other comprehensive income (loss)	1,047	(40)	1,007
Balance at December 31, 2009	$(3,371)	$(305)	$(3,676)

Additional detail regarding the classification of accumulated other comprehensive loss is included in Notes 13 and 14.

(16) Business Restructuring Charges

2009 Restructuring Plans

In 2009, the Reserve Banks continued their check restructuring initiatives to align check-processing infrastructure and operations with declining check-processing volumes. Additional announcements in 2009 included restructuring plans associated with discontinuing check print sites.

2008 Restructuring Plans

In 2008, the Reserve Banks announced the acceleration of their check-restructuring initiatives to align the check-processing infrastructure and operations with declining check-processing volumes. The new infrastructure consolidates operations into two regional Reserve Bank processing sites in Cleveland and Atlanta. Additional announcements in 2008 included restructuring plans associated with the closure of a check processing contingency center and the consolidation of check adjustments sites.

2007 and Prior Restructuring Plans

The Reserve Banks incurred various restructuring charges prior to 2008 related to aligning the check-processing infrastructure and operations with declining processing volumes. The new infrastructure would involve consolidation of operations into four regional Reserve Bank processing sites in Philadelphia, Cleveland, Atlanta, and Dallas. Additional announcements in 2007 included restructuring plans associated with the U.S. Treasury's Collections and Cash Modernization initiative. The Reserve Banks incurred various restructuring charges prior to 2007 related to the initial phases of restructuring of the System's check-processing and cash-handling infrastructure.

Following is a summary of financial information related to the restructuring plans (in millions):

	2007 and prior restructuring plans	2008 restructuring plans	2009 restructuring plans	Total
Information related to restructuring plans as of December 31, 2009:				
Total expected costs related to restructuring activity	$ 52	$ 18	$ 4	$ 74
Estimated future costs related to restructuring activity	$ 2	$ -	$ -	$ 2
Expected completion date	2012	2010	2010	
Reconciliation of liability balances:				
Balance at January 1, 2008	$ 43	$ -	$ -	$ 43
Employee separation costs	5	17	-	22
Adjustments	(4)	-	-	(4)
Payments	(21)	-	-	(21)
Balance at December 31, 2008	$ 23	$ 17	$ -	$ 40
Employee separation costs	-	-	4	4
Adjustments	(1)	(1)	-	(2)
Payments	(16)	(7)	-	(23)
Balance at December 31, 2009	$ 6	$ 9	$ 4	$ 19

Employee separation costs are primarily severance costs for identified staff reductions associated with the announced restructuring plans. Separation costs that are provided under terms of ongoing benefit arrangements are recorded based on the accumulated benefit earned by the employee. Separation costs that are provided under the terms of one-time benefit arrangements are generally measured based on the expected benefit as of the termination date and recorded ratably over the period to termination. Restructuring costs related to employee separations are reported as a component of "Salaries and other benefits" in the Combined Statements of Income and Comprehensive Income.

Adjustments to the accrued liability are primarily due to changes in the estimated restructuring costs and are shown as a component of the appropriate expense category in the Combined Statements of Income and Comprehensive Income.

Restructuring costs associated with the impairment of certain Reserve Banks' assets, including software, buildings, leasehold improvements, furniture, and equipment, are discussed in Note 11. Costs associated with enhanced pension benefits for all Reserve Banks are recorded on the books of the FRBNY as discussed in Note 13. Costs associated with enhanced postretirement benefits are disclosed in Note 14.

(17) Subsequent Events

In February 2010, the System discontinued a contractual relationship in connection with a large-scale software development program for which the Reserve Banks had recorded costs of $34.2 million as of December 31, 2009. The Reserve Banks expect that a portion of these costs, which are recorded as a component of "Other assets," will be expensed in 2010.

On March 1, 2010, AIG announced a definitive agreement with Prudential plc for the sale of the AIA Group for approximately $35.5 billion, including approximately $25 billion in cash, $8.5 billion in Prudential plc equity securities, and $2.0 billion in Prudential plc preferred stock. The cash proceeds from the sale will be used to redeem the FRBNY's preferred interests in AIA LLC of approximately $16 billion and to repay approximately $9 billion under the FRBNY's line of credit agreement with AIG. Proceeds from the orderly sale, over time, of AIG's holdings of Prudential plc equity securities, following the agreed on holding periods, will be used to repay amounts outstanding under the FRBNY's line of credit agreement with AIG.

On March 8, 2010, AIG announced a definitive agreement for the sale of ALICO to MetLife, Inc. for approximately $15.5 billion, including approximately $6.8 billion in cash and $8.7 billion in MetLife, Inc. equity securities, including common stock and convertible preferred securities. The cash proceeds from the sale will be used to redeem the FRBNY's preferred interests in ALICO LLC of approximately $9 billion. Proceeds from the orderly sale, over time, of AIG's holdings of MetLife, Inc. equity securities, following the agreed on holding periods, will be used to redeem the remainder of the FRBNY's preferred interests in ALICO LLC, and any residual proceeds will be used to repay amounts outstanding under the FRBNY's line of credit agreement with AIG.

On April 8, 2010, an agreement was reached to modify approximately $4.1 billion of commercial mortgage and mezzanine loans held in ML's investment portfolio. These loans, which represent ML's largest investment based on unpaid principal balance, are reported as hospitality loans in the table in Note 9 that discloses the concentration of unpaid principal balances in ML's investment portfolio. The key provisions of the modification include the discounted payoff of certain mezzanine loans, the conversion of most junior mezzanine loans to perferred equity, an extension of the final maturity date of the remaining loans from 2013 to 2015, and an increase in interest rates and fees. The FRBNY is evaluating the modification and does not believe that it will result in an adverse effect on the FRBNY's consolidated financial statements. Similarly, the modification is not expected to have an adverse effect on the combined financial statements.

There were no subsequent events that require adjustments to or disclosures in the combined financial statements as of December 31, 2009. Subsequent events were evaluated through April 21, 2010, which is the date that the Board issued the combined financial statements.

Office of Inspector General Activities

The Office of Inspector General (OIG) for the Federal Reserve Board operates in accordance with the Inspector General Act of 1978, as amended. The OIG conducts activities and makes recommendations to promote economy and efficiency; enhance policies and procedures; and prevent and detect waste, fraud, and abuse in Board programs and operations, including functions that the Board has delegated to the Federal Reserve Banks. Accordingly, the OIG plans and conducts audits, inspections, evaluations, investigations, and other reviews relating to Board and Board-delegated programs and operations. It also retains an independent auditor to annually audit the Board's and the Federal Financial Institutions Examination Council's financial statements. In addition, the OIG keeps the Congress and the Chairman of the Board of Governors fully informed about serious abuses and deficiencies.

During 2009, the OIG completed 13 audits, inspections, evaluations, and other reviews (table), and conducted a number of follow-up reviews to evaluate action taken on prior recommendations. Due to the sensitive nature of some of the material, certain reports were only issued internal to the Board, as indicated. The OIG also closed one investigation, issued two semiannual reports to Congress, and performed over 60 reviews of legislation and regulations related to the operations of the Board and/or the OIG.

For more information, visit the OIG website at www.federalreserve.gov/oig/.

OIG Audit, Inspection, and Evaluation Reports Issued in 2009

Report title	Month issued
Audit of Blackberry and Cell Phone Internal Controls	March
Report on the Inspection of the Board's Law Enforcement Unit (Internal Report)	March
Federal Financial Institutions Examination Council Financial Statements as of and for the Years Ended December 31, 2008, and 2007, and Independent Auditors' Report	March
Security Control Review of the Audit Logging Provided by the Information Technology General Support System (Internal Report)	March
Board of Governors of the Federal Reserve System Financial Statements as of and for the Years Ended December 31, 2008, and 2007, and Independent Auditors' Report	March
Security Control Review of the Electronic Security System (Internal Report)	June
Material Loss Review of First Georgia Community Bank	June
Material Loss Review of County Bank	September
Material Loss Review of Riverside Bank of the Gulf Coast	September
Audit of the Board's Processing of Applications for the Capital Purchase Program under the Troubled Asset Relief Program	September
Audit of Management and Accountability of Mobile Computing Devices (Internal Report)	October
Audit of the Board's Information Security Program	November
Material Loss Review of Michigan Heritage Bank	December

Government Accountability Office Reviews

Under the Federal Banking Agency Audit Act (Public Law 95–320), most Federal Reserve System operations are under the purview of the Government Accountability Office (GAO). In 2009, the GAO completed 20 reports on selected aspects of Federal Reserve operations (table). In addition, four projects concerning the Federal Reserve were in various stages of completion at year-end (table). The Federal Reserve also provided information to the GAO during the year on numerous other GAO investigations, including eight other completed reviews and two other ongoing reviews.

The reports are available directly from the GAO.

Reports Completed during 2009

Report title	Report number	Month issued (2009)
Financial Regulation: A Framework for Crafting and Assessing Proposals to Modernize the Outdated U.S. Financial Regulatory System	GAO-09-216	January
Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues	GAO-09-296	January
Bank Secrecy Act: Suspicious Activity Report Use Is Increasing, but FinCEN Needs to Further Develop and Document Its Form Revision Process	GAO-09-226	February
Bank Secrecy Act: Federal Agencies Should Take Action to Further Improve Coordination and Information-Sharing Efforts	GAO-09-227	February
Systemic Risk: Regulatory Oversight and Recent Initiatives to Address Risk Posed by Credit Default Swaps	GAO-09-397T	March
National Cybersecurity Strategy: Key Improvements Are Needed to Strengthen the Nation's Posture	GAO-09-432T	March
Financial Regulation: Review of Regulators' Oversight of Risk Management Systems at a Limited Number of Large, Complex Financial Institutions	GAO-09-499T	March
Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues	GAO-09-504	March
Inspectors General: Independent Oversight of Financial Regulatory Agencies	GAO-09-524T	March
Designated Federal Entities: Survey of Governance Practices and the Inspector General Role	GAO-09-270	April
Federal Reserve Banks: Areas for Improvement in Information Security Controls	GAO-09-722R	May
Reverse Mortgages: Product Complexity and Consumer Protection Issues Underscore Need for Improved Controls over Counseling for Borrowers	GAO-09-606	June
Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues	GAO-09-658	June
Fair Lending: Data Limitations and the Fragmented U.S. Financial Regulatory Structure Challenge Federal Oversight and Enforcement Efforts	GAO-09-704	July
Financial Markets Regulation: Financial Crisis Highlights Need to Improve Oversight of Leverage at Financial Institutions and across System	GAO-09-739	July
Troubled Asset Relief Program: Status of Government Assistance Provided to AIG	GAO-09-975	September

Reports Completed during 2009—*continued*

Report title	Report number	Month issued (2009)
Influenza Pandemic: Key Securities Market Participants Are Making Progress, but Agencies Could Do More to Address Potential Internet Congestion and Encourage Readiness	GAO-10-8	October
Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges	GAO-10-16	October
Small Business Administration: Actions Needed to Improve the Usefulness of the Agency's Lender Risk Rating System	GAO-10-53	November
Financial Audit: Bureau of the Public Debt's Fiscal Years 2009 and 2008 Schedules of Federal Debt	GAO-10-88	November

Projects Active at Year-End 2009

Subject of project	Month initiated
Systemic risk determination	October 2008
Governance issues relating to the Troubled Asset Relief Program (TARP)	July 2009
U.S. Treasury's Capital Purchase Program	November 2009
Bank walkaways	December 2009

Index

Index