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The Role of the Federal Reserve in Preserving Financial and Monetary Stability Joint Statement by the Department of the Treasury and the Federal Reserve

Federal Reserve System: Board of Governors

United States: Department of the Treasury

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Joint Press Release

March 23, 2009

The Role of the Federal Reserve in Preserving Financial and Monetary Stability Joint Statement by the Department of the Treasury and the Federal Reserve

Board of Governors of the Federal Reserve System

Department of the Treasury

For release at 4:30 p.m. EDT

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Introduction

Sound economic performance requires both financial stability and monetary stability. As the nation's central bank, the Federal Reserve has critical responsibilities in both areas.

The Congress created the Federal Reserve in 1913 in large part in response to the periodic panics and crises that plagued the U.S. financial system in the 19th and early 20th centuries. Over nearly a century, in the service of its original mandate as well as its monetary and regulatory responsibilities, the Federal Reserve has developed wide-ranging institutional expertise regarding financial markets and institutions, foreign as well as domestic. The Federal Reserve also has the unique ability to serve as the lender of last resort, a vital function in crises. For these reasons, it is natural and desirable that the Federal Reserve should play a central role, in cooperation with the Department of the Treasury and other agencies, in preventing and managing financial crises.

While the Federal Reserve has traditionally collaborated with other agencies in efforts to preserve financial stability, it alone is responsible for maintaining monetary stability. The monetary policy-making arm of the Federal Reserve, the Federal Open Market Committee (FOMC), determines monetary conditions in the United States, subject to its congressional mandate to foster maximum sustainable employment and stable prices. The Federal Reserve's independence with regard to monetary policy is critical for ensuring that monetary policy decisions are made with regard only to the long-term economic welfare of the nation.

This joint statement reflects the common views of the Treasury and the Federal Reserve on the appropriate roles of the Federal Reserve and the Treasury during the current financial crisis and in the future and on the steps necessary to ensure that both financial and monetary stability will be achieved.

The Treasury and the Federal Reserve agree on the following broad points:

1. Treasury-Federal Reserve cooperation in improving the functioning of credit markets and fostering financial stability

The Federal Reserve's expertise and powers are indispensable for preventing and managing financial crises. The programs it has initiated since the onset of this crisis have played a critical role in helping to contain the damage to the broader economy. As long as unusual and exigent circumstances persist, the Federal Reserve will continue to use all its tools working closely and cooperatively with the Treasury and other agencies as needed to improve the functioning of credit markets, help prevent the failure of institutions that could cause systemic damage, and to foster the stabilization and repair of the financial system.

2. The Federal Reserve to avoid credit risk and credit allocation

The Federal Reserve's lender-of-last-resort responsibilities involve lending against collateral, secured to the satisfaction of the responsible Federal Reserve Bank. Actions taken by the Federal Reserve should also aim to improve financial or credit conditions broadly, not to allocate credit to narrowly-defined sectors or classes of borrowers. Government decisions to influence the allocation of credit are the province of the fiscal authorities.

3. Need to preserve monetary stability

Actions that the Federal Reserve takes, during this period of unusual and exigent circumstances, in the pursuit of financial stability, such as loans or securities purchases that influence the size of its balance sheet, must not constrain the exercise of monetary policy as needed to foster maximum sustainable employment and price stability. Treasury has in place a special financing mechanism called the Supplementary Financing Program, which helps the Federal Reserve manage its balance sheet. In addition, the Treasury and the Federal Reserve are seeking legislative action to provide additional tools the Federal Reserve can use to sterilize the effects of its lending or securities purchases on the supply of bank reserves.

4. Need for a comprehensive resolution regime for systemically critical financial institutions

The Treasury and the Federal Reserve remain fully committed to preventing the disorderly failure of systemically critical financial institutions. To reduce the risk of future crises, the Treasury and the Federal Reserve will work with the Congress to develop a regime that will allow the U.S. government to address effectively at an early stage the potential failure of any systemically critical financial institution. As part of the framework set forth, the legislation should spell out to the extent possible the expected role of the Federal Reserve and other U.S. government agencies in such resolutions.

In the longer term and as its authorities permit, the Treasury will seek to remove from the Federal Reserve's balance sheet, or to liquidate, the so-called Maiden Lane facilities made by the Federal Reserve as part of efforts to stabilize systemically critical financial institutions.

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