Reuters - Fed's Sack: Higher yields due to economic optimism

By Kristina Cooke
PHILADELPHIA | Wed Feb 9, 2011 5:54pm EST

(Reuters) - The U.S. Federal Reserve's recent bond purchases have had a "helpful" effect on financial conditions, with the rise in long-term interest rates largely due to economic optimism, a senior Fed official said on Wednesday.

Brian Sack, who is in charge of implementing Fed policy as head of the New York Fed's markets group, said a "significant" rise in U.S. Treasury yields since November does not appear to reflect inflation concerns.

"The upward movement in longer-term interest rates in large part reflects the greater optimism about the outlook for economic growth," Sack said.

The Fed in November launched a second round of asset buys to support a fragile economic recovery, to total $600 billion over eight months. The yield on the 10-year Treasury note, which moves inversely to its price, has risen from 2.49 percent in November to 3.65 percent at the close on Wednesday.

"The rise in yields does not appear to be driven by the concerns expressed by some that the asset purchase program would unleash a considerable rise in U.S. inflation and inflation expectations," Sack said.

Longer-term inflation expectations have stayed consistent with the Fed's price stability mandate, risky asset prices have risen, and the dollar has "held its ground," he said.

The Fed's approach to implementing the purchases -- "presumably some of the largest and most rapid portfolio adjustments that have ever taken place by any single financial market participant" -- was flexible enough to avoid significant market distortions, he said.

Sack said the Fed has received "competitive and appropriate" prices for the bonds it has bought. He added that market liquidity appears to be "decent" and the Fed does not see signs of scarcity in any particular Treasury securities.

The Fed "has not lost any momentum" in its preparation for its eventual exit from easy money policy, Sack said.

He said more than 500 firms have registered for the term deposit facility and the New York Fed has added 58 money market funds as counterparties for reverse repurchase agreements.

Both tools would be ways for the Fed to tighten policy by temporarily draining reserves from the financial system.

The amount of income the Fed's portfolio will generate over the long-term is uncertain, Sack said. But any losses the Fed would incur if interest rates moved up abruptly would not affect its ability to implement monetary policy, he said.

(Reporting by Kristina Cooke; Editing by Leslie Adler)

Bloomberg

Sack Says Fed's Asset Purchases Have Led to `More Accommodative' Markets

By Caroline Salas - Feb 9, 2011 6:51 PM ET

Brian Sack, the Federal Reserve Bank of New York's markets group chief, said the central bank's asset-purchase program has supported the economic recovery by easing market conditions.

"The Federal Reserve's balance sheet actions have helped to make broader financial conditions more accommodative," Sack said in the text of remarks given in Philadelphia today. "Risky asset prices such as equities have risen at a rapid pace, and credit spreads and measures of credit availability have continued to ease."

Sack is among Fed officials defending the central bank's decision last month to press ahead with its plan to buy $600 billion of bonds through June in an effort to create jobs. Republican Representative Paul Ryan of Wisconsin, chairman of the House Budget Committee, today repeated his criticism of the purchases, saying they risk creating asset-price bubbles and fueling inflation.

"The recent asset purchases by the Federal Reserve have had helpful effects on financial conditions and have been implemented in a manner that has been flexible enough to avoid any significant negative consequences for the functioning of financial markets," Sack said.

Fed Chairman Ben S. Bernanke said in testimony before the House budget panel today that the unemployment rate is likely to remain high "for some time" even after its biggest two-month drop since 1958, to 9 percent in January. Joblessness rose above 9 percent in May 2009, beginning the longest period of unemployment at that level or higher since monthly records began in 1948.

Adding to Concerns

Ryan today said an increase in long-term Treasury yields this week "certainly adds to these concerns" about inflation. The benchmark 10-year Treasury note yields 3.65 percent, up from 2.57 percent on Nov. 3, the day the Fed announced its asset- purchase program.

The increase "in large part reflects the greater optimism among investors about the outlook for economic growth," Sack said. "The rise in yields does not appear to be driven by the concerns expressed by some that the asset purchase program would unleash a considerable rise in U.S. inflation."

Sack said in response to audience questions that rising Treasury yields reflect that "there's a lot more confidence in the markets that we're seeing the beginnings of a more sustained, robust recovery." Equity prices "should have come down," if that weren't true, he said. The Standard & Poor's 500 Index has gained more than 10 percent since Nov. 3.

Dual Mandate

Bernanke said today that "inflation is expected to persist below the levels that Fed policy makers have judged to be consistent" with their dual mandate from Congress for stable prices and maximum employment.

Sack said while the central bank has been pressing ahead with quantitative easing, it has also been preparing to withdraw its record monetary stimulus.

"Even as the Federal Reserve has been expanding its balance sheet, it has not lost any momentum in the preparation of its exit tools," Sack said. "We continue to make considerable progress increasing our capacity to drain reserves if necessary."

More than 500 depository institutions have registered for the Fed's term deposit facility, and 58 money-market funds have been added as counterparties for reverse repurchase agreements, Sack said. Last week, the Fed also added two firms as primary dealers, or counterparties to the central bank's transactions.

"We have already established considerable capacity to drain reserves with these two tools, and we will continue to advance them in productive directions," Sack said.

To contact the reporter on this story: Caroline Salas in New York at csalas1@bloomberg.net

To contact the editor responsible for this story: Christopher Wellisz at cwellisz@bloomberg.net

Dow Jones - NY Fed Official: Fed Bond Buying Hasn't Compromised Treasury Market Functioning

By Michael S. Derby

NEW YORK (Dow Jones)--The Treasury market continues to function normally despite significantly sized bond buying by the Federal Reserve, a key central bank staffer said Wednesday.

"Our purchases do not appear to be causing significant strains on the liquidity or functioning of the Treasury market," Federal Reserve Bank of New York executive vice president Brian Sack said. The official heads the regional Fed's Markets Group and is responsible for implementing the monetary policy directives of the central bank.

Sack was addressing the impact on the government bond market of the Fed's program to buy $600 billion in longer-dated Treasurys by mid-year, which is joined with a large-sized operation to invest the proceeds of Fed-owned mortgage securities into the government bond market as well.

Private sector analysts have observed Fed purchases are so large as to absorb the equivalent of almost all new Treasury debt issuance, although it's important to note the Fed is not buying at Treasury auctions and is instead buying in the secondary market from the primary dealer banks it traditionally deals with.

Sack noted "it is unusual for the market to have such a large, persistent, and one-sided participant." He added "the available evidence suggests that market liquidity is decent at this time" and "we do not see signs that the market is facing unusual scarcity of particular Treasury securities."

Sack attributed the smooth dealings to a well paced program that has the flexibility to buy securities that are most attractive and most readily available through dealers.

The New York Fed official's comments came from a speech in Philadelphia before a gathering of the Global Interdependence Center. He spoke on the same day as Fed Chairman Ben Bernanke and, unsurprisingly, he echoed many of the views of the central bank leader. Bernanke also noted the Treasury market is taking the Fed's interventions well, and he countered those who argue the Fed is monetizing budget deficits by noting the central bank will eventually sell off what it has purchased.

Sack offered a sunshine-tinged account of the bond buying, saying it has had "helpful effects on financial conditions and have been implemented in a manner that has been flexible enough to avoid any significant negative consequences for the functioning of financial markets."

He dismissed those who assert a rise in bond yields since the program started last year signals failure for an effort that was supposed to help lower bond costs.

"The upward movement in longer-term interest rates in large part reflects the greater optimism among investors about the outlook for economic growth" and the gains do not signal greater worry about inflation, the official said. "Longer-term inflation expectations have remained at levels consistent with the Federal Reserve's mandate," he said, adding "risky asset prices have advanced and the dollar has held its ground."

Asked by an audience member if the market had bought the rumor and sold the fact on the Fed buying, Sack said that while it was clear the market anticipated the program, there would have been a decline in stock prices if investors had just sold on the fact. Sack again stressed that it was the revision in the outlook on the economy that propelled yields. He later said that the market thought the size of the Fed's buying would be beyond $600 billion.

Sack also countered those who worry the rapid expansion of the Fed's balance sheet could prove problematic should interest rates rise sharply, and he said the central bank has the tools it needs to unwind its stimulative policy when the time come. Concern has been rising that a surge in short-term rates would cut into the hefty profits the Fed now earns on its holdings, and potentially expose the central bank to losses, which in turn could compromise its policy making independence.

"Even if interest rates did move up abruptly and the SOMA portfolio experienced realized losses, it would have no meaningful operational consequences for the Federal Reserve's ability to implement monetary policy," Sack said.

Any losses would be realized over time, Sack said in response to a question. Indeed, even with the recent rise in rates, the Fed's portfolio has "large unrealized gains," Sack said.

As for undoing what's been done, the New York Fed official said the Fed's ability to pay interest rates on reserves, which should help keep liquidity out of the market, will be "the critical tool." Sack also said "we continue to make considerable progress increasing our capacity to drain reserves if necessary."

Sack declined to comment on the prospect of a third round of quantitative easing. Asked about future changes to the framework around the federal funds rate, he said it's something the Federal Open Market Committee will have to decide as "the world re-normalizes." He also said anything that happens to the mortgage market would affect the Fed, in response to another question.

-By Michael S. Derby, Dow Jones Newswires, 212-416-2214; michael.derby@dowjones.com

--Romy Varghese in Philadelphia contributed to this article.