

THE FEDERAL RESERVE SYSTEM

Date: October 11, 2013
To: Federal Open Market Committee
From: Bill English and Simon Potter
Subject: Potential Policy Responses to the Debt Ceiling

We once again face the case where the limit for the Federal debt ceiling will soon become binding and the Treasury is quickly running out of the additional borrowing capacity it can achieve under various accounting procedures. Under these circumstances, the chances for a technical default on Treasury securities through missed or delayed principal or coupon payments cannot be ruled out. The staff discussed this possibility and potential Federal Reserve policy responses in a memo to the Committee in July 2011.¹ This memo revisits the potential responses considered in 2011, considers additional options, and makes some recommendations.

As in 2011, the potential responses include decisions on how securities with delayed payments will be handled in routine operations—including open market operations, securities lending transactions, and discount window lending—as well as actions that could be taken specifically in response to market strains resulting from delayed payments on Treasury securities or market participants' reactions to a higher probability of such an event that could have significant consequences for financial stability or the economy. Some of these policy responses are covered in the current authorization that the FOMC has given to the Open Market Trading Desk at the Federal Reserve Bank of New York (the Desk), while others would require additional authorization. Decisions about the discount window instead reside with the Board of Governors and the individual Reserve Banks, but these decisions are included in the discussion because they serve similar purposes to some of the actions that could be taken by the Desk.

We begin by describing how delayed payments could affect five routine policy actions that are permissible under the Federal Reserve Act and fall within the current authorization of the

¹ See Bill English and Brian Sack “Potential Policy Responses to the Debt Ceiling” memo to the FOMC, July 19, 2011.

