Fed Pumps Further $630 Billion into Financial System

By Scott Lanman and Craig Torres

Sept. 29 (Bloomberg) -- The Federal Reserve will pump an additional $630 billion into the global financial system, flooding banks with cash to alleviate the worst banking crisis since the Great Depression.

The Fed increased its existing currency swaps with foreign central banks by $330 billion to $620 billion to make more dollars available worldwide. The Term Auction Facility, the Fed's emergency loan program, will expand by $300 billion to $450 billion. The European Central Bank, the Bank of England and the Bank of Japan are among the participating authorities.

The Fed's expansion of liquidity, the biggest since credit markets seized up last year, came hours before the U.S. House of Representatives rejected a $700 billion bailout for the financial industry. The crisis is reverberating through the global economy, causing stocks to plunge and forcing European governments to rescue four banks over the past two days alone.

``Today's blast of term liquidity will settle the funding markets down, and allow trust to slowly be restored between borrowers and lenders,'' said Chris Rupkey, chief financial economist at Bank of Tokyo-Mitsubishi UFJ Ltd. in New York. On the other hand, ``the Fed's balance sheet is about to explode.''

The MSCI World Index of stocks in 23 developed markets sank 6 percent, the most since its creation in 1970. Credit markets deteriorated further as authorities tried to save more financial institutions from collapse.

European Rescue

European governments have rescued four banks in two days and the Federal Deposit Insurance Corp. said today it helped Citigroup Inc. buy the banking operations of Wachovia Corp. after its shares collapsed. The Standard & Poor's 500 Index fell 3.8 percent and the cost of borrowing dollars for three months rose to the highest since January. The rate for euros hit a record.

``If people think the authorities may give in to fears, they are wrong,'' Financial Stability Forum Chairman Mario Draghi said today in Amsterdam, where the international group of regulators and finance officials is meeting. ``There is willingness and determination on winning the battle to restore confidence and stability.''

Banks and brokers have slowed lending as they struggle to restore their capital after $586 billion in credit losses and writedowns since the mortgage crisis began a year ago. The bankruptcy of Lehman Brothers Holdings Inc. also sparked fears among banks they wouldn't be repaid by counterparties, driving up the cost of short-term loans between banks.

Funding Risk

``By committing to provide a very large quantity of term funding, the Federal Reserve actions should reassure financial market participants that financing will be available against good collateral, lessening concerns about funding and rollover risk,'' the central bank said.

The Bank of England and the ECB will each double the size of their dollar swap facilities with the Fed to as much as $80 billion and $240 billion, respectively. The Swiss National Bank and the Bank of Japan will also double their dollar swap lines, while the central banks in Australia, Norway, Sweden, Denmark and Canada tripled theirs.

All the banks extended their facilities until the end of April 2009.

The Fed is also increasing the size of its three 84-day TAF sales to $75 billion apiece, from $25 billion. That means the Fed will make a total of $225 billion available in 84-day loans. The central bank will keep the sales of 28-day credit at $75 billion.

Special Sales

In addition, the Fed will hold two special TAF sales in November totaling $150 billion so banks can have funding available for one or two weeks over year-end. The exact timing and terms will be determined later, the Fed said. The TAF program began in December, totaling $40 billion.

The bank-rescue plan being debated by Congress today would give the Fed more power over short-term interest rates by providing authority as of Oct. 1 to pay interest on reserves held at the central bank by financial institutions. That would make it easier for the Fed to pump funds into the banking system.

Paying interest on reserves puts a ``floor'' under the traded overnight rate, which would allow a central bank ``to provide liquidity during times of stress'' without affecting the rate, New York Fed economists said in a paper last month.

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