



## Reserve Market Rates and Discount Window Lending

10.11.07

At its September 18 meeting, the Federal Open Market Committee (FOMC) voted to lower the target federal funds rate 50 basis points to 4.75 percent. This was the first rate reduction since the last round of rate increases ended in June 2006.

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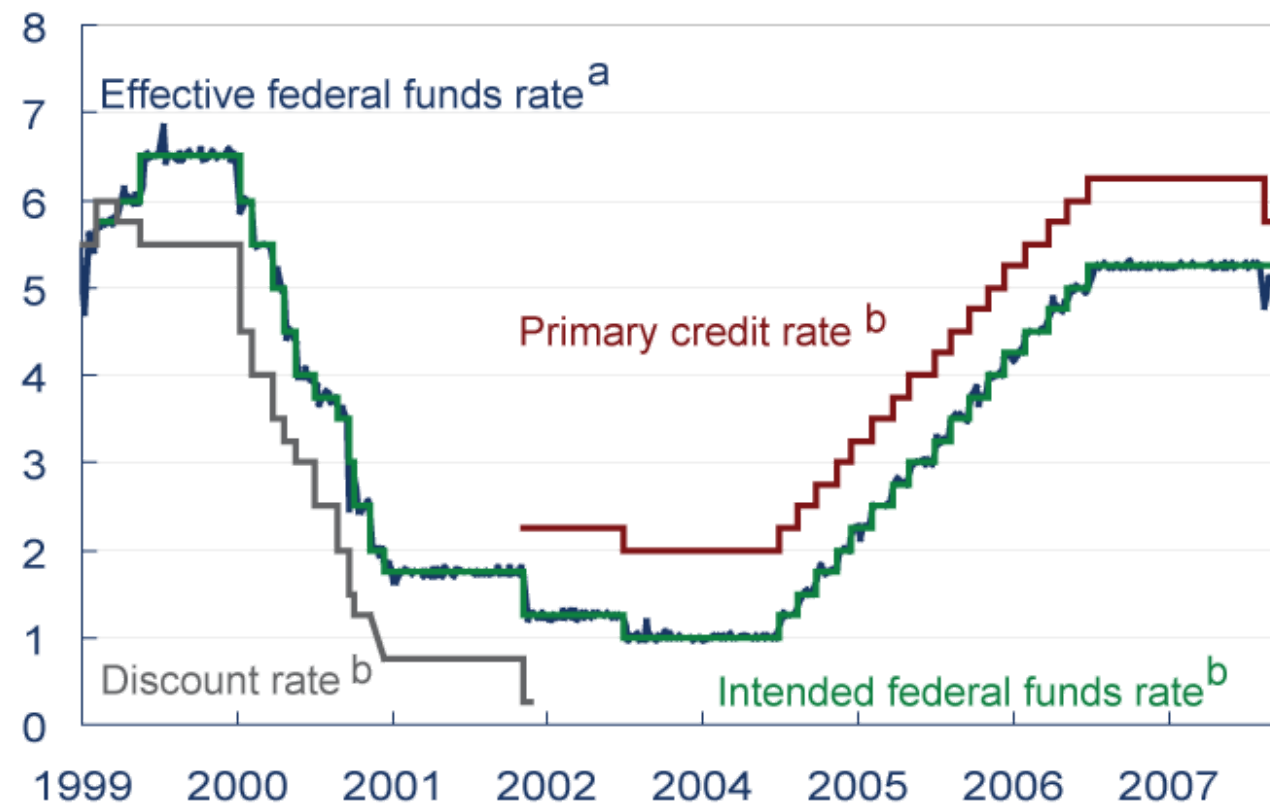
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# Reserve Market Rates

Percent



a. Weekly average of daily figures.

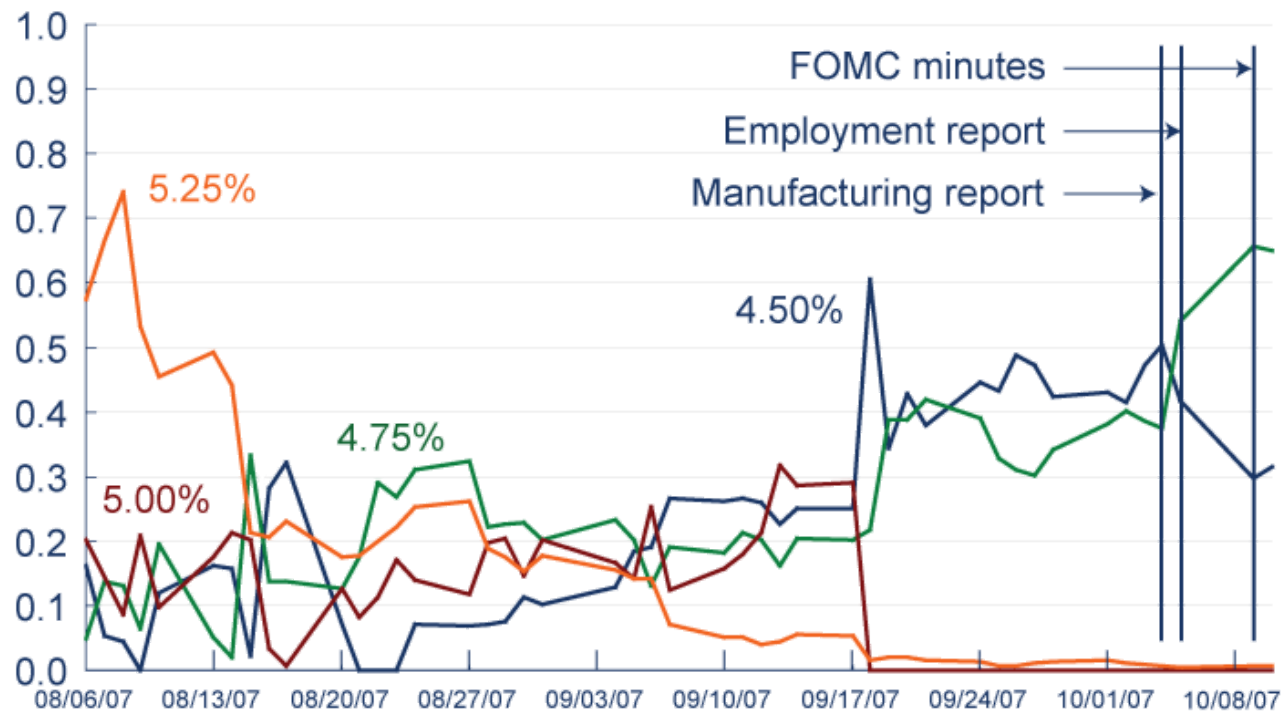
b. Daily observations.

Sources: Board of Governors of the Federal Reserve System, "Selected Interest Rates," *Federal Reserve Statistical Releases*, H.15.

Since that meeting, participants in the Chicago Board of Trade's federal funds options market have seen it as ever more probable that the outcome of October's meeting would be to leave the funds rate at 4.75 percent. For instance, on September 19, markets were evenly split between no change and a further 25 basis point reduction at the October meeting, with just less than a 40 percent probability for each possibility. But by the beginning of October, participants actually placed a slightly higher probability on a 25 basis point cut as opposed to no rate change at the October meeting. However, a favorable employment report on October 5 reversed this, tilting the probabilities in favor of no rate change.

# Implied Probabilities of Alternative Target Federal Funds Rates October Meeting Outcome\*

Implied probability



\*Probabilities are calculated using trading-day closing prices from options on November 2007 federal funds futures that trade on the Chicago Board of Trade.

Source: Chicago Board of Trade and Bloomberg Financial Services.

# Implied Yields on Federal Funds Futures



a. One day after FOMC meeting.

Sources: Chicago Board of Trade and Bloomberg Financial Services.

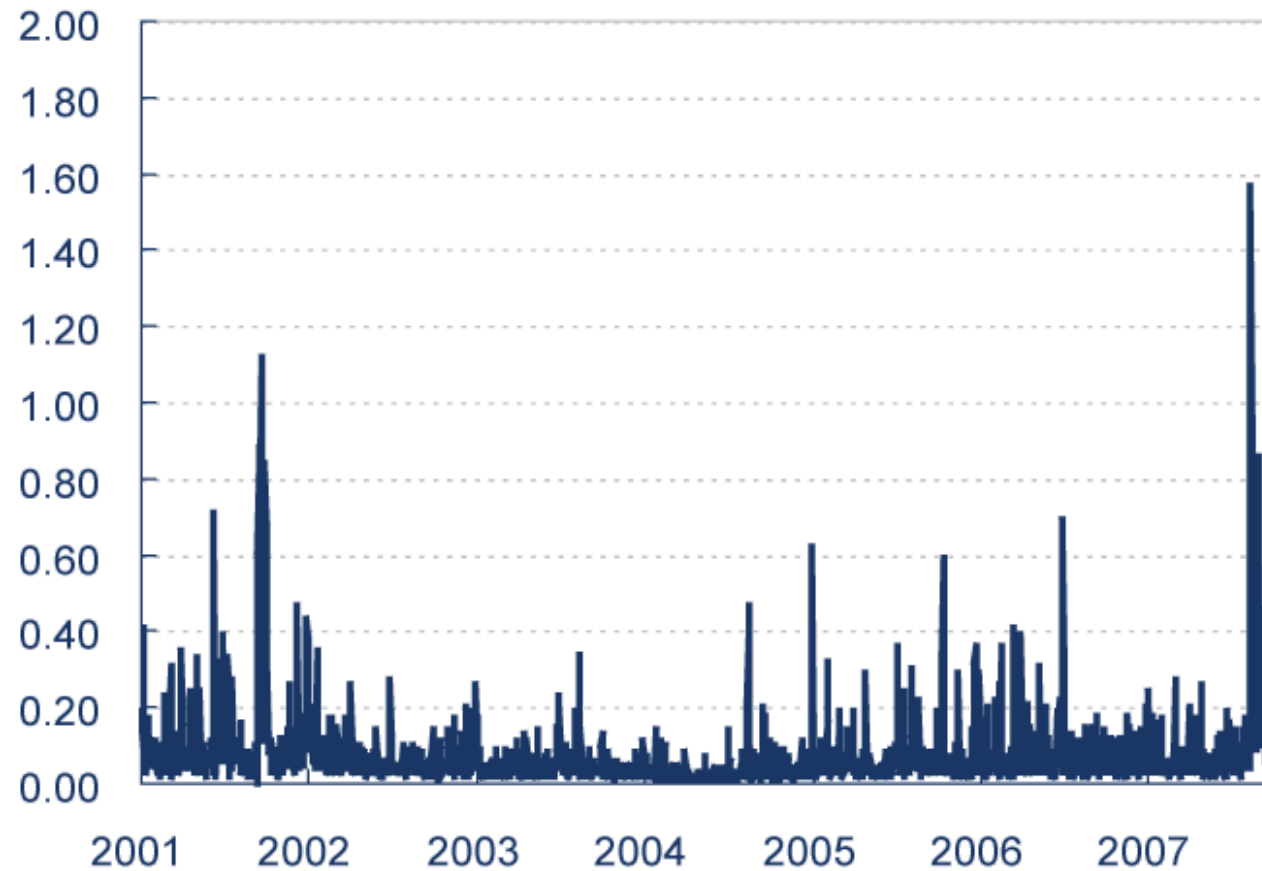
On October 9, the FOMC released the minutes of its September 18 meeting. In the minutes, the committee noted, "The information reviewed at the September meeting suggested that economic activity advanced at a moderate rate early in the third quarter." The minutes also discussed the "exceptionally weak" housing sector, noting "deteriorating conditions in the subprime mortgage market" and indicating that "the availability of financing to borrowers recently appeared to have been crimped even further." Meeting participants expressed concern that developments in credit markets could potentially "restrain aggregate demand in coming quarters." Participants also noted that although there had been some improvement in financial market conditions in the days prior to the September meeting, conditions "were still fragile." Committee members voted for a 50 basis point cut in the funds rate as the "most prudent course of action" to "forestall some of the adverse effects" of credit market conditions.

The release of the minutes did have a mild impact on market participants' views of the future course of monetary policy. The minutes' release further shifted options market participants' views toward no change in policy at the October meeting, and participants currently place over a 65 percent probability on no change in policy in October. Meanwhile, the federal funds futures market indicates the possibility of a further rate cut by year's end.

During August and September, the federal funds rate exhibited marked volatility. This volatility coincided with the general financial market volatility. Whereas the intraday standard deviation for the funds rate has averaged around 8 basis points since 2001, the intraday standard deviation for August and September averaged over 33 basis points and reached a high of 1.57 percent on August 10. For the majority of the operating days during those two months, the effective rate was below the intended rate - up to 71 basis points on August 14 - leading some commentators to proclaim that the committee had effectively cut the funds rate before its September 18 meeting to curtail possible negative effects from increased financial market volatility.

# Standard Deviation of the Federal Funds Rate

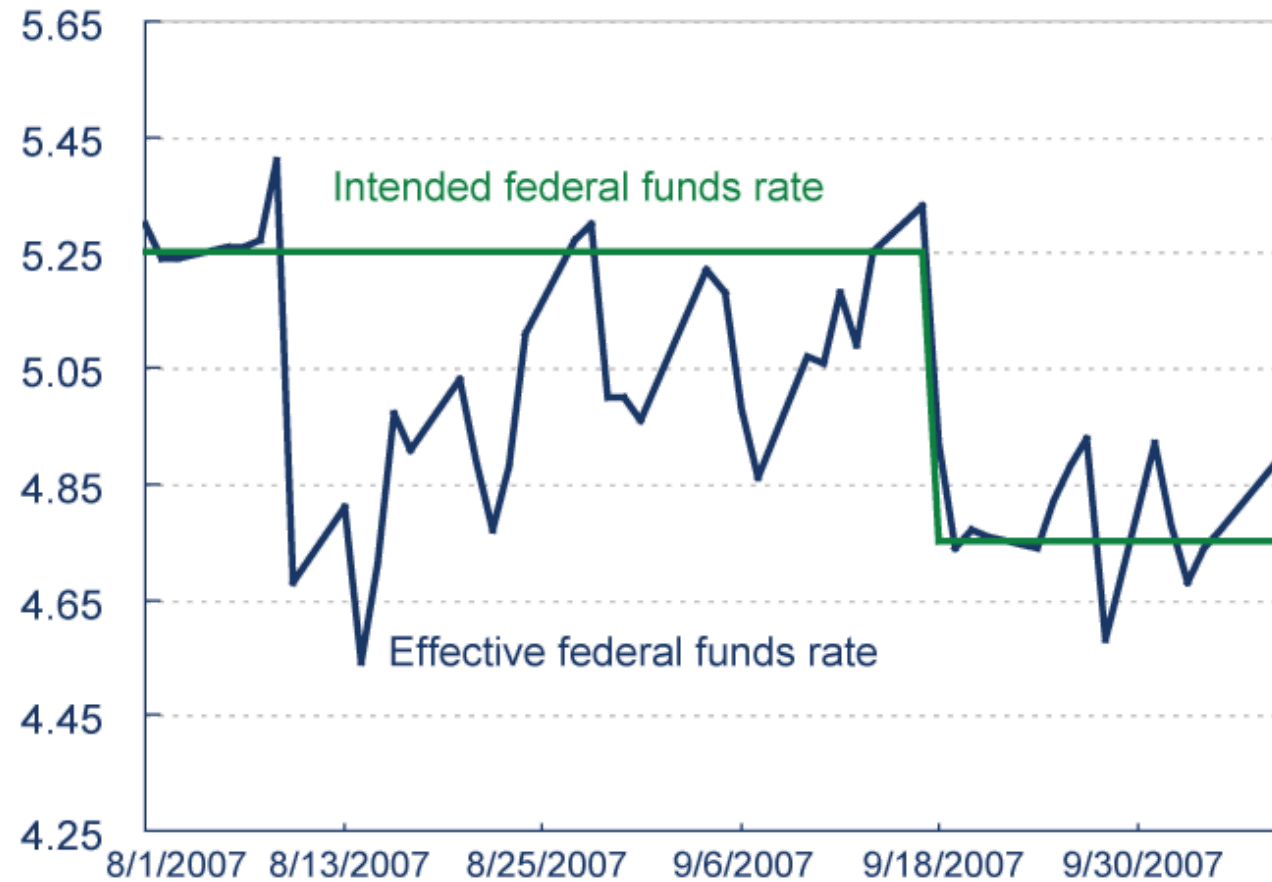
Percent



Source: Federal Reserve Bank of New York.

# Reserve Market Rates

Percent



Source: Federal Reserve Bank of New York.

Another way the Federal Reserve attempted to fight financial market volatility in August was through its primary and secondary credit facility. Since January 9, 2003, the Federal Reserve has extended discount window loans to depository institutions through its primary and secondary credit facilities. Primary credit is available to generally sound financial institutions at an interest rate above the federal funds rate. Federal Reserve Banks extend secondary credit in appropriate circumstances to financial institutions that do not qualify for primary credit. For most of the period since its inception, the

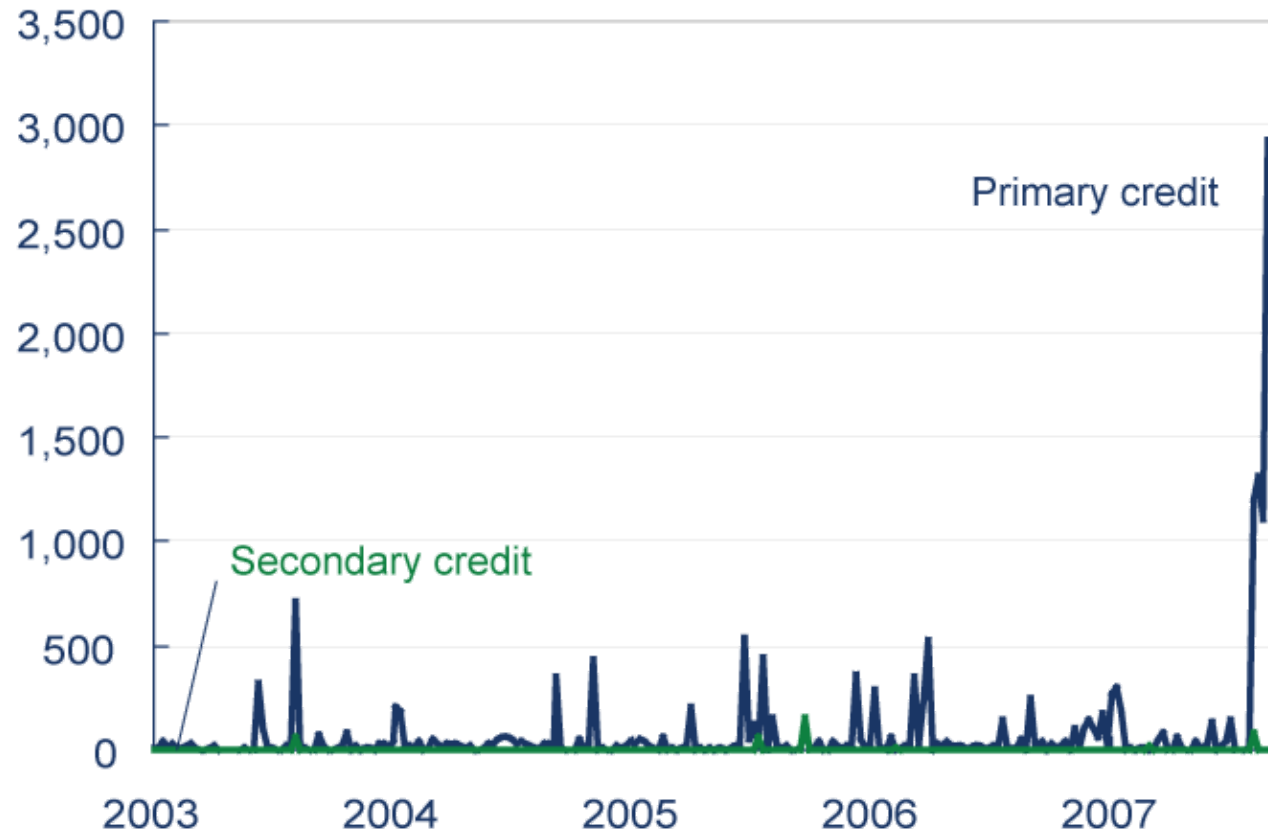
primary credit rate has been set at 100 basis points above the federal funds rate. The secondary credit rate is set at 50 basis points above the primary credit rate. Under these programs, the volume of discount window lending typically has been small. Primary credit outstanding has averaged \$82 million, with outstanding secondary credit averaging \$2 million.

Shortly after the August FOMC meeting, concern developed in financial markets about potential liquidity problems and counterparty credit risk. On August 10, the Fed stated it was "providing liquidity to facilitate the orderly functioning of financial markets." On that day, the Trading Desk of the New York Fed conducted temporary open market purchases of \$38 billion. On August 17, 2007, amidst signs of increased turmoil in financial markets, the Federal Reserve Board lowered the primary credit rate to 5.75 percent - 50 basis points above the funds rate - and provided for 30-day term lending through the discount window. The use of primary credit subsequently surged. From mid-August to mid-September, primary credit outstanding averaged over \$1.7 billion. It has subsequently settled down to near-normal levels.



# Reserve Bank Credit: Loans to Depository Institutions

Average, millions of dollars



Source: Federal Reserve Board.

## Headlines

06.28.22

[Planning for Surprises, Learning from Crises: The 2021 Financial Stability Conference](#) ▶

Joseph G. Haubrich

This *Commentary* summarizes the academic papers and keynote talks delivered at the 2021 Financial Stability Conference hosted by the Office of Financial Research and the Federal Reserve Bank of Cleveland, held virtually on November 17–19, 2021. [Read More](#) ▶

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Stephan D. Whitaker

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06.02.22

Feeding Families during a Pandemic: Trends from a Northeast Ohio Food Bank ▶

Merissa Piazza

Food insecurity has been a familiar issue for many lower-income households. But pandemic-related school and business closures put additional families in a new territory of needing to supplement their food budgets. [Read More](#) ▶

## Upcoming Events

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07.14.22

What’s Ahead for the Community Reinvestment Act: A Discussion

A virtual session this July will explain the first major changes proposed in more than a quarter century to the Community Reinvestment Act (CRA).

09.29.22

Inflation: Drivers and Dynamics Conference 2022

The Inflation: Drivers and Dynamics 2022 conference, co-sponsored by the Center for Inflation Research and the European Central Bank will take place on September 29-30, 2022 in Cleveland, OH.

10.06.22

Conference on Real-Time Data Analysis, Methods, and Applications

The Federal Reserve Bank of Cleveland is sponsoring the Annual Conference on Real-Time Data Analysis, Methods, and Applications in Macroeconomics and Finance to be held in Cleveland, Ohio, at the Cleveland Reserve Bank on Thursday and Friday, October 6–7, 2022.

11.17.22

2022 Financial Stability Conference: Frontier Risks, a New Normal, and Policy Challenges

The Federal Reserve Bank of Cleveland and the Office of Financial Research will host their 10th annual financial stability conference on November 17–18, 2022. This year's conference is titled Financial Stability: Frontier Risks, a New Normal, and Policy Challenges.

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