1. INTRODUCTION

The Federal Reserve undertook numerous measures to mitigate the effects of the financial crisis that started in August 2007.The central bank eased the terms with which it provided liquidity to depository institutions and launched a range of new programs to provide liquidity to other institutions.

"Central banks may be best suited to provide liquidity because they have better information about the solvency of banks or because they have the ability to finance the entire banking sector's liquidity needs by virtue of their size and their unique ability to issue money (Flannery 1996)"

Since the Great Depression, the Fed has provided liquidity to individual institutions by way of its discount window, through which the Fed makes fully collateralized short-term loans to depository institutions at a penalty rate. During the crisis, the Fed initially adjusted the terms of discount window use to expand liquidity provision to depository institutions. It proceeded to introduce numerous additional facilities to increase the flexibility with which institutions could access liquidity, new programs.

2. FEDERAL RESERVE RESPONSE TO THE CRISIS

The Federal Reserve employed both conventional and unconventional policy on an unprecedented scale during the financial crisis. To address the deteriorating economic outlook, the Fed lowered the fed funds target rate 10 times between September 2007 and December 2008, to an ultimate level close to zero. Moreover, to address the disruptions in financial markets, the Federal Reserve introduced or expanded liquidity facilities, provided support for specific institutions, and engaged in direct purchases of assets.

<u>Liquidity Provision to Banks</u>: The start of the financial crisis, and the initial policy responses, are often dated to August 2007, when problems in the interbank lending market emerged. On August 10, the Fed announced that it was providing liquidity to financial markets using its usual tools of open-market operations and the discount window. One week later, on August 17, the Fed announced temporary changes to its primary credit discount window facility to reduce depository institutions. On December 12, 2007, the Fed auctioned loans to depository institutions. The Fed also established reciprocal currency arrangements, or swap lines, with the European Central Bank and the Swiss National Bank on December 12, 2007.

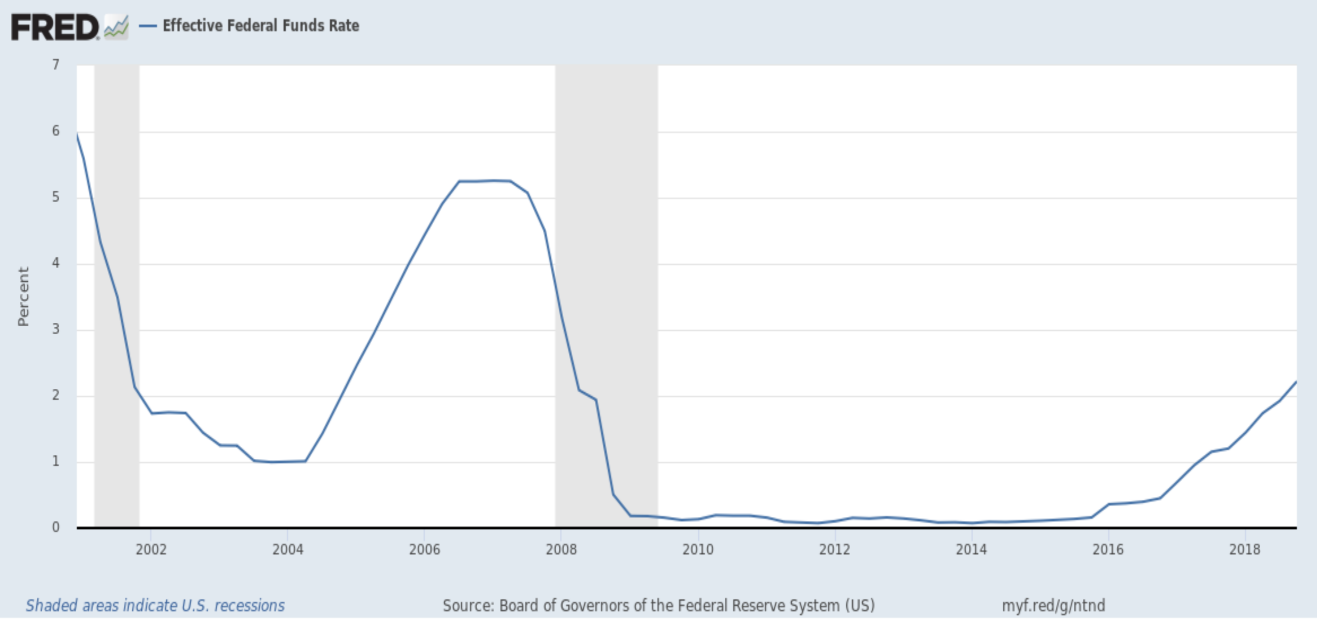
<u>Liquidity Provision to Dealers</u>: In early 2008, the secured funding markets relied on by dealers became severely impaired. To address liquidity pressures in the term funding markets relied on by dealers, the Fed announced on March 7 that it would initiate a series of single-tranche open-market operations in which primary dealers could bid to borrow funds through repos.

<u>Liquidity Provision to Other Market Participants</u>: The bankruptcy of Lehman Brothers on September 15, 2008 led to an unparalleled broadening and intensification of money market disruptions.

<u>Other Actions:</u> Aside from its use of conventional policy and liquidity facilities, the Federal Reserve took other extraordinary actions during the financial crisis. To improve market conditions, the Fed instituted programs to purchase assets directly. (The Fed also provided support for specific institutions during the crisis to promote financial market stability. In March 2008, it provided special financing to facilitate the acquisition of Bear Stearns by JPMorgan Chase. In September and October 2008, the Fed provided support for AIG (American International Group) to assist the firm in meeting its obligations, to facilitate the orderly sale of some of its businesses, and to finance the fixedincome securities it held. In November 2008 and January 2009, the Fed agreed to provide credit under certain conditions to Citigroup and Bank of America, respectively.)

Las facilidades concedidas por la fed trataron de aumentar la liquidez de los mercados financieros ofertando préstamos a corto plazo a empresas solventes, a unas tasas de interés superiores al coste normal de los fondos.

5. CONCLUSION The Federal Reserve initiated or expanded numerous liquidity facilities during the financial crisis of 2007–2009 in accord with its lender-of-last-resort role. The evidence supports the conjecture that the facilities were structured in line with time-honored principles of central bank liquidity provision: short-term lending against collateral at a penalty rate. The evidence uncovered to date also broadly supports the conclusion that the programs were effective at mitigating the strains in financial markets. New transaction-level data now provide an unusual opportunity to further understanding of liquidity facility utilization and effectiveness.


FRED
— Effective Federal Funds Rate
Percent
7
6
5
4
3
2
1
0
2002
2004
2006
2008
2010
2012
2014
2016
2018
Shaded areas indicate U.S. recessions
Source: Board of Governors of the Federal Reserve System (US)
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