While a commodity standard forces accountability on the central bank, “it did not always work because governments sometimes changed the rate between the commodity and the currency,” Bullard said. “Inflation targeting is another way to force more accountability to the central bank and anchor longer-term expectations. Make the central bank say what it intends to do,” he said, “and hold the central bank accountable for achieving the goal.”

“Inflation targeting,” Bullard concluded, “is the appropriate modern alternative to historical commodity standards.”

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- **January 27, 2011**. Article. "The Fed's Emergency Liquidity Facilities: Why They Were Necessary," Federal Reserve Bank of St. Louis *The Regional Economist*, January 2011.

President's Message: The Fed's Emergency Liquidity Facilities: Why They Were Necessary

As the lender of last resort, a central bank typically lends extensively—though at a penalty rate—during a crisis. The Federal Reserve took such actions to stabilize the financial system and avoid further stress during the financial crisis that began in early August 2007. The Fed created a number of temporary liquidity programs in 2007 and 2008 to provide sound institutions with necessary access to credit. [[1]](https://www.stlouisfed.org#endnotes)

Initially, the Fed encouraged depository institutions to come to the discount window for funding. On Aug. 17, 2007, the Fed decided to reduce the spread between the primary credit rate and the target federal funds rate to 50 basis points. The loan maturity was also extended from overnight to a maximum of 30 days. Despite the narrower spread and longer maturity, relatively few institutions came to the discount window out of concern that borrowing

from the discount window might be perceived as a sign of financial weakness.

With the financial crisis intensifying, the Fed created the Term Auction Facility (TAF) in December 2007 so that institutions could purchase funds in the open market without going to the discount window, thus circumventing the stigma. Under TAF, the Fed auctioned a fixed amount of term funds on a biweekly basis; these loans had a maximum maturity of 84 days. For the first auction, the total dollar amount of bids was more than triple the dollar amount of loans accepted. The overwhelming demand for the TAF loans provides evidence that stigma associated with discount-window borrowing mattered during the crisis.

U.S. financial markets were further stressed by problems in short-term dollar funding markets. In response the Fed established dollar liquidity swap lines with some foreign central banks. Under this program, a foreign central bank sold its currency to the U.S. in exchange for dollars and then lent the dollars to its own institutions. At most three months later, the currencies were swapped back, with the foreign central bank paying interest to the Fed. The program helped ease strains in these dollar funding markets during the crisis and was reinstituted in May 2010 to help address renewed problems in European markets.

TAF and the currency swap program gave depository institutions a much-needed source of short-term liquidity. In addition, the Fed created programs in March 2008 to provide primary security dealers with short-term credit. Under the Primary Dealer Credit Facility, primary dealers obtained overnight collateralized loans at the primary credit rate. The Term Securities Lending Facility (TSLF) allowed primary dealers to borrow Treasury securities for 28 days in exchange for other eligible, less-liquid securities. A few months later, the Fed established the TSLF Options Program to offer extra liquidity (for up to two weeks) during periods of elevated financial stress, such as end-of-quarter periods. TSLF loans and TSLF options were both awarded through auctions.

Later in 2008, the Fed created programs to ease the liquidity problems of other markets and institutions. The Asset-Backed Commercial Paper Money

Market Mutual Fund Liquidity Facility helped to stabilize money market mutual funds that held illiquid asset-backed commercial paper; without help, the money funds had difficulty meeting investors' demands for redemptions. The Commercial Paper Funding Facility was designed to increase liquidity in the commercial paper market—a primary source of funding for businesses—and to provide assurances that eligible commercial paper issuers would be able to repay their investors. Finally, the Term Asset-Backed Securities Loan Facility was created to stabilize the asset-backed securities market, thus addressing the credit needs of households and small businesses.

In implementing the above liquidity programs, the Fed followed standard risk-management practices to the extent possible. Only sound institutions with good collateral met the eligibility requirements to borrow under these programs. In addition, the institutions could borrow only a fraction of their collateral, with the fraction depending on the particular collateral. As a result, the Fed did not lose any money on programs that have already closed.

During the financial crisis, the Fed also provided liquidity to systemically important financial institutions—those considered "too big to fail." In March 2008, the New York Fed provided short-term credit to Bear Stearns through JPMorgan Chase Bank, which the company repaid. Shortly thereafter, the New York Fed provided credit to the newly created Maiden Lane LLC for purchasing a portion of Bear Stearns' mortgage assets; this loan enabled JPMorgan to acquire the remainder of Bear Stearns, avoiding bankruptcy of the latter. In September 2008, the New York Fed provided credit to the American International Group (AIG) to prevent its disorderly failure. A few months later, two newly created LLCs received loans from the New York Fed to purchase certain assets and debt obligations from AIG. These were some of the most controversial decisions made during the entire financial crisis.

Overall, the emergency liquidity programs proved to be successful at improving the functioning of financial markets. Most of the programs were closed naturally as the financial crisis subsided because the borrowers found better terms in the private sector. The Federal Reserve Board recently released detailed information regarding these emergency liquidity programs. Their size and variety demonstrate how flexible and powerful the

lender-of-last-resort function can be during a crisis.

Endnotes
1. For information on the programs, see www.federalreserve.gov/monetarypolicy/bst.htm [[[back to text](https://www.stlouisfed.org#1##1)]]

The Regional Economist offers insights on regional, national and international issues. Views expressed are not necessarily those of the St. Louis Fed or Federal Reserve System.

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St. Louis Fed's Bullard: The U.S. Economic Situation and Recent Monetary Policy Developments

WASHINGTON, D.C. - In remarks Thursday at a meeting of the National Economists Club, St. Louis Fed President James Bullard discussed his perspective on the recent Federal Open Market Committee policy decision to pursue additional quantitative easing.

In his [presentation](https://www.stlouisfed.org/-/media/project/frbstl/stlouisfed/files/pdfs/bullard/remarks/nbe_washingtondec2_2010_final.pdf) , “The U.S. Economic Situation and Recent Monetary Policy Developments,” Bullard also addressed some of the risks and criticisms of the FOMC policy decision. Bullard said that while this policy carries both risks and rewards, he believes the benefits outweigh the risks., “The U.S. Economic Situation and Recent Monetary Policy Developments,”