November 2001

Monetary*Trends*

THE FEDERAL RESERVE BANK of ST. LOUIS

September 11, 2001

The September 11 terrorist attack on the World Trade Center and the Pentagon was not only a human tragedy but also an event with potentially serious ramifications for the economy. Although the airline and insurance industries face severe long-term problems as a result of the attack, the event posed an immediate threat to the entire economy by disrupting the payments and financial systems. Specifically, while the attack increased firms' and individuals' demand for liquidity, heightened uncertainty and the possibility of falling asset prices also threatened to reduce lending by banks and other intermediaries. Significant disruption to the payments system or lending has the potential to slow economic activity markedly.

In response to the attack, the Federal Reserve provided additional liquidity through several channels to help restore confidence and ensure the continued functioning of the financial and payments systems. First, the Fed's New York Trading Desk injected an unusual amount of liquidity through repurchase agreements (repos). The accompanying table shows that the Fed held $61 billion of securities acquired under repurchase agreements on September 12, versus an average of $27 billion on the previous ten Wednesdays (see table) and about $12 billion on September 13, 2000.

Second, the Federal Reserve lent money directly to banks through the discount window. The $45 *billion* in discount loans outstanding on September 12 dwarfed the $59 *million* average of the previous 10 Wednesdays.

Third, the Federal Reserve—along with the Comptroller of the Currency—urged banks to restructure loans for borrowers with temporary liquidity problems. To assist such restructuring, the Fed stood ready with additional funds.

Fourth, because transportation difficulties prevented checks from being cleared in a timely manner, the Federal Reserve extended almost $23 billion in check "float" on September 12, some 30 times the average float over each of the 10 previous Wednesdays.

Fifth, the Federal Reserve quickly established or extended "swap lines" with foreign central banks, such as the European Central Bank, the Bank of England, and the Bank of Canada. These accords enable central banks to temporarily exchange currencies to meet liquidity needs in foreign currencies. For example, the Fed and the European Central Bank might swap dollars for euros for a specified period of time, to enable the ECB to loan dollars to branches of European banks operating in the United States.

Finally, the FOMC reduced the federal funds rate target by 1/2 percentage point, to 3 percent, early on Monday, September 17, while retaining the balance of risks toward economic weakness in its public statement. This action was interpreted as a confidence-boosting measure for the reopening of the New York Stock Exchange later that morning.

Deposits at Federal Reserve Banks conveniently summarize the liquidity provided to the economy. On September 12, this measure stood at $102 billion, more than 5 times the average of the previous 10 Wednesdays. As in previous periods of financial stress (e.g., the crash of 1987, the Russian default of 1998, and the Y2K scare) the Federal Reserve's actions helped ensure the smooth functioning of the payments and financial systems, thereby minimizing the economic repercussions of the tragedy.

—Christopher J. Neely

Monetary Conditions

	Repos	Discount window lending	Float	Deposits at Federal Reserve Banks
Average of Wednesdays from July 4 to September 5, 2001	27298	59	720	19009
September 12, 2001	61005	45528	22929	102704
September 19, 2001	39600	2587	2345	13169

NOTE: Data were taken from the H.4.1 statistical release from the Board of Governors. Only weekly averages and Wednesday figures are available in that report. Figures are reported in millions of U.S. dollars. Deposits at Federal Reserve Banks is the sum of "service related balances and adjustments" and "reserve balances with FR Banks."