

# A Black Swan in the Money Market

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## Abstract

The recent financial crisis saw a dramatic and persistent jump in interest rate spreads between overnight federal funds and longer - term interbank loans. The Fed took several actions to reduce these spreads including the creation of the Term Auction Facility (TAF). The effectiveness of these policies depends on the cause of the increased spreads such as counterparty risk, liquidity, or other factors. Using a no-arbitrage pricing framework and various measures of risk, we find robust evidence that increased counterparty risk contributed to the rise in spreads but do not find robust evidence that the TAF had a significant effect on spreads. (JEL E43, E44, E52, G21)

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