



The five posters in this report date from the mid-1920s and were intended for display by member banks. The 12 regional Reserve Banks supervise member banks as part of the Federal Reserve System's mandate to promote strength and stability in the nation's domestic markets and banking system.

President's Foreword

The U.S. economy rolled on in the early months of 2007, continuing its solid performance of the past several years. Still, some observers detected imbalances in the U.S. economy that posed risks to its continued expansion—imbalances that had been building for several years.

By late summer, it became clear that upbeat economic projections for 2007 would be sorely tested by a housing downturn, and that some financial companies closely tied to the housing sector would suffer losses. Then, as fall turned to winter, signs of a more serious credit crunch began to take shape. Ongoing stresses in the housing and mortgage markets began to affect liquidity not just in the domestic financial sector, but across the globe, as winter progressed into 2008.

The Federal Reserve System has responded to this turmoil with a series of timely actions. The Federal Open Market Committee has sharply lowered its federal funds rate target and has taken steps to make its large holdings of Treasury securities available to financial market participants. In related actions, the Board of Governors has initiated several changes in the discount window operations of the Reserve Banks. Some of these actions are unprecedented in Federal Reserve history.

A financial crisis provides perhaps the most tangible opportunity for a central bank to fulfill its role in fostering financial stability. The proper response, however, depends on the reasons behind the crisis and on the costs and benefits of resolving any related market failure. Central bankers must also keep in mind the intended and unintended consequences of their response to the crisis at hand.

This year's *Annual Report* essay, advanced by three of our Research economists, offers some lessons from the past that may be useful in placing current events in perspective. More important, these lessons may help guide policymakers in planning ahead to manage future financial crises. The particular mechanisms that the authors propose are less important than the principle of preplanning, to the extent possible, for the inevitable dislocations in financial markets. A good crisis prevention environment also requires aligning policies and practices among all agencies involved in the chartering, regulating, supervising, and insuring of financial institutions.

The Operational Highlights section of this report, beginning on page 22, complements the main essay with a more detailed analysis of the discount window and the Federal Reserve Bank of Cleveland's role in supporting the central bank's monetary policy activities.



While critically important, monetary policy support is just one of many functions that helped the Federal Reserve Bank of Cleveland advance its strategic objectives and achieve solid performance in 2007.

The Bank advanced its thought leadership objective in the areas of policy analysis, research, banking supervision, payments, and support to the U.S. Treasury. Beyond our work in financial stability, highlights include initiating a research study to improve survey-based measurement of inflation expectations; managing significant growth in the electronification of check services as a result of Check 21 legislation; and serving as a national business leader for eGovernment and Treasury Retail Securities.



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*R. Chris Moore, first vice president and chief operating officer;
Sandra Pianalto, president and chief executive officer;
Tanny B. Crane, chairwoman; and
Alfred M. Rankin Jr., deputy chairman.*

In 2007, the Bank also strengthened its external focus objective, designed to foster public understanding of the Federal Reserve System's mission and to inform our contributions to monetary policy. The Bank provided information and analysis on regional and national economic issues through academic research, speeches, and a strong community presence. The Community Affairs function hosted its fifth annual Policy Summit, which focused on foreclosures, vacant and abandoned properties, and new sources of community development. Also, the Bank's Learning Center and Money Museum welcomed more than 10,000 visitors, hosted two special exhibits, and provided educational outreach.

The Bank also continued to advance its strategic objective of operational excellence. Cleveland was named one of four regional check-processing sites in the Federal Reserve System, while the Retail Payments Office continues to manage the ongoing consolidation of check operations across the nation. In addition, the Bank was selected to develop and administer four key operations for the U.S. Treasury and earned high marks for customer service and support. The Cash function also consistently met aggressive operational and financial targets.



The Bank's boards of directors and advisory councils in Cleveland, Pittsburgh, and Cincinnati were instrumental in guiding our success in 2007.

I extend a deep measure of thanks to Henry L. Meyer III, chairman and CEO of KeyCorp, who is stepping down from our Cleveland Board of Directors after three years. Henry has brought energy and commitment to his term of office, including participation on two board committees. I am delighted that he has agreed to serve as the Bank's Federal Advisory Council representative in 2008.

I also thank Edwin J. Rigaud, president and CEO of Enova Partners in Cincinnati, who served on our Cleveland Board of Directors as well as two board committees. We greatly valued his insights and counsel.

Thanks also go to two retiring members of our Pittsburgh Board of Directors: Robert O. Agbede, president and CEO of Chester Engineers in Pittsburgh, served for six years and was chairman of the Pittsburgh board in 2007. Michael J. Hagan, president and CEO of Iron and Glass Bank in Pittsburgh, also served for two three-year terms. We thank Bob and Mike for their dedicated service and leadership.

From our Cincinnati board, we say farewell to two directors who have also provided six years of service each: Herbert R. Brown, senior vice president for Western & Southern Financial Group in Cincinnati, and James H. Booth, president of Czar Coal Company in Lovely, Kentucky. Herb and Jim have brought unique insights to our Bank, and we greatly appreciate their contributions.

Finally, I thank George W. Schaefer Jr., chairman of Fifth Third Bancorp in Cincinnati, who has served as our Bank's representative on the Federal Advisory Council for the past two years. George's leadership has been outstanding.

At the Federal Reserve Bank of Cleveland, we continue to advance our strategic objectives of leadership in thought and deed, external focus, and operational excellence. In this effort, we are driven by the diversity, talent, and dedication of more than 1,500 employees in our Cleveland, Cincinnati, and Pittsburgh offices. I am indebted to the Bank's officers and staff for all of their contributions to our success.

I know that no matter what the challenges we face, the Federal Reserve Bank of Cleveland has a wealth of human capital—in terms of innovative and engaged directors and employees—to sustain and strengthen us.

Sandra Pianalto
President and Chief Executive Officer