

## Key Interest Rate Definitions

**Federal Funds Rate** - The interest rate (annualized) charged among financial institutions as they borrow and lend excess reserves from and to each other. For example, a large money center bank might borrow reserves from a credit union central for a few days, and will pay this rate. This is the **target interest rate** used by the **Federal Reserve System** in the execution of monetary policy. This rate is flexible and is determined by credit market conditions. If the FRS is "tightening up," for example, and restricting reserves to the system, this rate will rise in response.

**Discount Rate** - Set by the Federal Reserve Board of Governors, this is the rate charged by the FRS for direct loans of reserves from the FRS. A penalty rate is often added to the Discount Rate by the FRS. The FRS generally does not like banks and other financial institutions to borrow through the discount window. This rate is a "talking head" rate; it remains fixed for long periods of time, then an official announcement is made when it is changed. This rate has been discounted in importance in recent years and is seldom mentioned by the media.

**Prime Rate** - The benchmark rate used by commercial banks for their corporate borrowers. Commercial loans are usually negotiated at prime plus or minus some percent (such as "prime minus three percent" or "prime plus two percent"). The prime rate itself, in turn, is adjusted up and down as credit market conditions change, although the rate is usually "sticky," remaining at the same level for long periods of time. Because commercial loans are normally negotiated at prime plus or minus some percentage, this makes commercial loans more or less adjustable loans.

**Treasury Securities Rates** - The range of yields on U.S. Treasury Bills, Notes, and Bonds. The **30-Bond Rate** (the yield on a recently-issued U.S. Treasury 30-year bond), sometimes called the **Long-Bond Rate**, is sometimes regarded as a benchmark rate for long-term interest rates. The **10-year Note Rate** is now regarded as the benchmark intermediate term rate and is the Treasury Securities rate most watched by the finance markets.

**Corporate Securities Rates** - The full range of interest rates quoted on the entire spectrum of corporate securities, which vary not only by maturity but also by the risk ratings assigned to these issues by the large rating agencies like Standard and Poor and Moody. Companies with very high credit risks can have their notes and bonds essentially rated as "junk bonds," which often have yields considerably higher than Treasury Securities and premium-grade corporate securities.

**Municipal Note and Bond Rates** - The rates on securities issued by state and local governments. Interest earned on these are always tax free for federal income taxes and typically tax free for state taxes if the owner lives in the state that issued the securities. Yields on these securities are, like corporate securities, highly dependent upon ratings issued by the big ratings agencies. Because of their favored tax status, yields on these securities are typically lower than their corporate equivalents.

**Mortgage Rates** - Generally, these are interest rates on mortgage loans, which are loans

used to finance home purchases. There are many classifications of mortgage loans. The three most common are shown here:

**30-year fixed rate** - A home loan with a fixed interest rate and equal monthly payments amortized over 30 years (meaning the borrower will make 360 equal monthly payments).

**15-year fixed rate** - The same as the 30-year fixed rate, but amortized over only 15 years.

**ARM (or VRM)** - Adjustable (or variable) rate mortgage. The loan is amortized over 30 years (or some other period of time), but the interest rate and hence the monthly payment is adjusted to conform to prevailing market rates. The loan typically has a "cap," or upper limit.