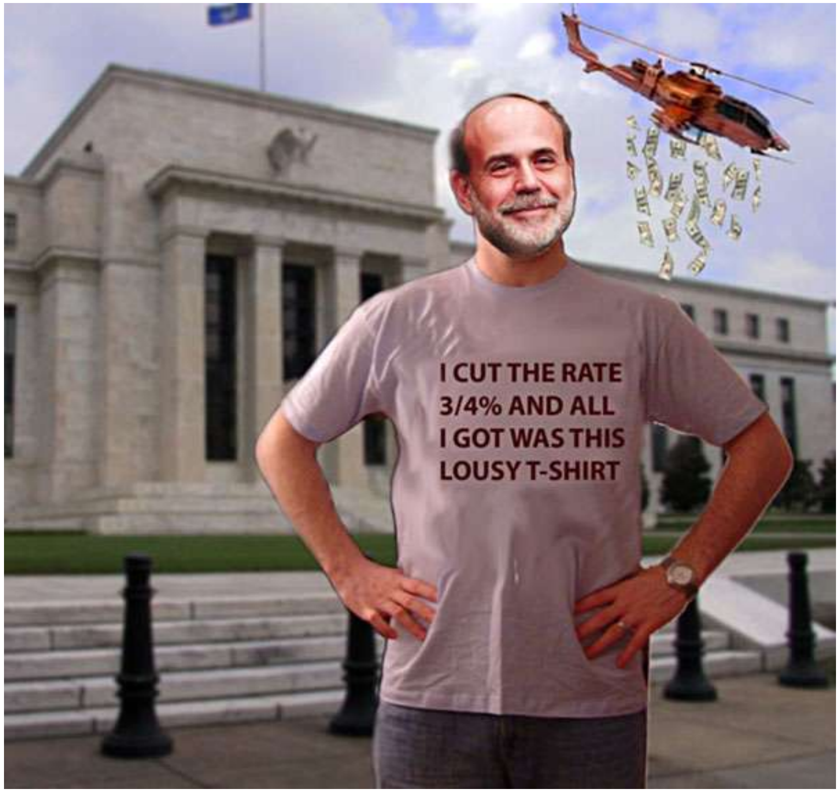


The Fed and Monetary Policy

When was the Fed Created?

- The Fed was created in 1914 after a series of bank failures.

What is the structure of the Fed?

The Fed Board of Governors:

- 7 members appointed by the President, with confirmation by the Senate.
- Board members serve 14-year terms.
- President appoints the chairperson to a 4-year term.

What is the structure of the Fed?

12 Regional Federal Reserve Banks:

- Regional banks are located in major cities around the country.
- Each bank has a president chosen by the bank's board of directors.
- The board of directors is typically drawn from the local business and banking community.

How is the Fed both government and private?

What is monetary policy?

- The Fed's policy for control of the amount of currency available and the rate at which people can borrow money

The Tools of Monetary Policy

Discount rate – the interest rate charged by the central bank on loans to commercial banks.

How does changing the discount rate affect the economy?

- When the discount rate increases,

- When the discount rate decreases,

The Tools of Monetary Policy

Open market operations – the central bank buys and sells government bonds

How does buying and selling bonds change the economy?

- When the Fed buys bonds,

- When the Fed sells bonds,

The Tools of Monetary Policy

Reserve requirement – the minimum level of deposit reserves commercial banks must hold.

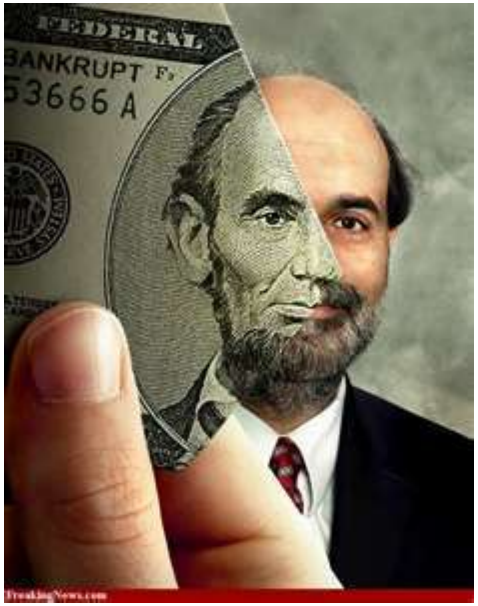
How does changing the reserve ratio affect the economy?

- When the reserve ratio increases,

- When the reserve ratio decreases,

Now it's time to ask yourself.....

- WWBBD?

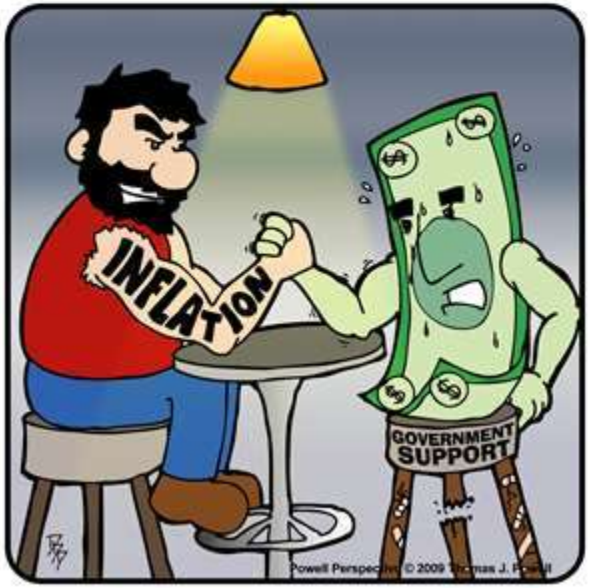


Expansionary Monetary Policy

- When the economy is in recession, the Fed may choose to EXPAND the economy by increasing the money supply and lowering interest rates.

Contractionary Monetary Policy

- When the economy is overheating or experiencing high inflation, the Fed may choose to CONTRACT the economy by decreasing the money supply and raising interest rates.



ools of Monetary Policy

Monetary Policy	Expansionary Policy	Contractionary Policy
A. Open market operations		
B. Discount rate		
C. Reserve requirements		

gure 38.4

ed Actions and Their Effects

Federal Reserve Action	Bank Reserves	Money Supply	Fed Funds Rate
. Sold Treasury securities on the open market	↑ ↓	↑ ↓	↑ ↓
. Bought Treasury securities on the open market	↑ ↓	↑ ↓	↑ ↓
. Raised the discount rate	↑ ↓	↑ ↓	↑ ↓
. Lowered the discount rate	↑ ↓	↑ ↓	↑ ↓
. Raised the reserve requirement	↑ ↓	↑ ↓	↑ ↓
. Lowered the reserve requirement	↑ ↓	↑ ↓	↑ ↓

To: Members of the Federal Reserve Board

Re: Current Economic Problems

I have received the following economic data and would appreciate your recommendations for future monetary policy.

	Unemployment Rate	Inflation Rate
Last Year	4.2%	2.6%
This Year	3.9%	5.4%
Forecast for Next Year	3.8%	7.3%

1. What is the major economic problem confronting the U.S. economy?

2. What appropriate actions should the Federal Reserve take to promote stability?

You write the prescription: What is the correct policy direction for each tool?

For the discount rate indicate whether you would want to increase or decrease the rate by writing "↑" for an increase or "↓" for a decrease in the appropriate box.

For the reserve requirement indicate whether you would want to increase or decrease the requirement by writing "↑" for an increase or "↓" for a decrease in the appropriate box.

For open market operations indicate whether you would want to buy or sell government bonds in the open market by writing buy or sell in the appropriate box.

	Monetary Policy Tool		
Problem	Discount Rate	Reserve Requirement	Open Market Operations
High Unemployment			
High Inflation			