UNDERSTANDING THE FEDERAL RESERVE

OBJECTIVES

- **Understanding The Fed Mission and Structure**

- **The Fed and Monetary Policy**
  - Money Supply
  - Interest Rates

About the Fed

Origination, Responsibilities, and Organization

ORIGINATION

- **Independent Governmental Entity**
- **Established by congress in 1913**
- **Central Bank of the United States**
- **Created to provide stability to the nation's Banks and economy**
- **Only governmental entity to turn a profit ($83 billion in 2012) – Market operations**

RESPONSIBILITIES

- **Formulating and executing monetary policy**
- **Supervising and regulating depository institutions**
- **Providing an elastic currency**
- **Assisting the Federal Government's financing operations**
- **Serving as the banker for the banking industry**

ORGANIZATION

- **Board of Governors (7 members)**

- **12 Regional Reserve Banks**

- **Federal Reserve Bank of New York is most important**
  - Implements Monetary Policy for Fed System
  - International Monetary Policy and Operations
  - Supervision and Regulation of largest depository institutions

THE FEDERAL RESERVE DUAL MANDATE

Promote Sustainable Economic Growth (control inflation)

- **Manage money supply**
- **Control Interest Rates**

Promote Optimum Employment (limit unemployment)

- **Optimize employment – some unemployment is necessary**
- **Finding right balance**

FED OPEN MARKET COMMITTEE (FOMC)

- **Formulates and directs monetary policy initiatives**
- **Permanent voting members: 7 Governors (Board of Governors) and New York Fed president**
- **Remaining 11 Reserve Bank presidents vote on rotating basis**

TREASURY VS FED

Treasury is financial manger for the federal government

Collects taxes and other revenue

Pays the governments bills

Manages budget

In charge of tracking federal debt

Fed controls money supply

Fed sets interest rates

Fed establishes and controls monetary policy (setting interest rates)

Economy is purview of the Fed

THE FED AND MONETARY POLICY

THE FED DURING THE PAST 15 YEARS

MONETARY POLICY

- **Manage money supply – using largest banks and broker/dealers**

Accomplished by buying and selling US Treasury securities

- More money in circulation – More money available promotes lending and investments.
- Too much money fuels inflation
- Fed creates money – not borrowed

- **Manage interest rates – short term rates**
  - Outcome of market operations
  - Fed Funds rate
  - Discount rate

FED IN 2009

Economic collapse –companies and banks losing money

Banks afraid to lend

No liquidity

Answer was to lower interest rates

Pump money into system – buy treasuries lend extensively

Buy lower rated securities

CAUSES OF CURRENT INFLATION

Cheap money due to low interest rates (mortgages, auto loans, credit, etc)

Low unemployment (3%)

Pandemic disrupted production (reduced supply)

Supply chain issues

KEY ECONOMIC METRICS

Sustainable economic growth

Inflation around 2%

Unemployment between 4 – 5%

Credit markets active – production and consumption

INTEREST RATES

Primary tool for affecting economic growth and controlling inflation

Low rates promote borrowing:

- **Corporate growth – provide jobs**
- **Mortgage loans**
- **Consumer loans**
- **Grow the economy**

High rates reduce borrowing:

- **Slow economic growth**
- **Reduce inflation**
- **Limit availability of money**

RISING INTEREST RATES

- **Fed finally raises interest rates in 2022**
  - Probably should have started process earlier
  - Rates increased rapidly to fight inflation
  - 6 months needed to measure impact of rate change

UNINTENDED CONSEQUENCES

Rapidly increasing rates lessen confidence in Fed

Regional bank failures (investment problems, customer withdrawals)

Interest rate volatility effect on financial markets

Discussion

Questions?