The Fed and monetary policy

Chapter 15

The Federal Reserve System

Structure

Private Ownership – member banks

Board of Governors – 7 members, appointed by Pres. & Senate, 14 term, vacant every two years

Job –regulatory, supervisory

Federal Open Market Committee – growth of $ supply and level of interest rates

Advisory Committees –

Consumer Advisory Council

Thrift Institutions Advisory Council -

Regulatory Responsibilities

State Member Banks –

Bank Holding Companies –

International Operations –

Member Bank Mergers –

Other Federal Reserve Services

Clearing checks, enforcing consumer legislation, maintaining currency and coins and providing financial services to the government

Monetary Policy

Modern banks operate on a fractional reserve system. Under this system excess reserves can be loaned out to other customers. (legal reserves, requirements & excess)

How they operate – liabilities, assets, balance-sheets, net worth, t-accounts, liquidity, savings accounts, time deposits.

Commercial banks charge interest on their loans and use the income to pay expenses, keeping the remainder as profit.

Fractional Reserves – allows MS to grow several times larger then the reserve (chart)

The size of the money supply is determined by the reserve requirement and the reserve in the system. An increase in the reserve requirement will shrink the money supply. A decrease in the requirement will expand the money supply.

Monetary policy affects the size of the money supply and therefore the level of interest rate.

The tools of monetary policy include: a change in the reserve requirement; open market operations, which involves the buying and selling of government bonds; and a change in the discount rate.

Two lesser tools include moral suasion and selective credit controls such as margin requirements.

Monetary Policy, banking & Economy

* Short Run Impact – affects the interest rate (prime rate)
* Long-Run Impact – affects the prices of goods or inflation
  + Historical precedents, Monetizing the Debt, Taming Inflation
* Other Monetary Policy Issues
  + Timing & Burden -
  + Present vs. Future Allocation
  + Defining Money – M1 & M2

Politics of Interest rates – low = good

The cost of economic instability

Chapter 16:1&4

The cost

Economies & politics

* Changing Nature of Economic Policy
  + Decline of Discretionary Fiscal Policy – someone implements it
  + Importance of Passive Fiscal Policies –
  + Structural Fiscal Policies –
  + Dominance of Monetary Policy –
* Why Economist Differ
  + Different Criteria – inflation etc.
  + Different Eras – 1930’s, 1960’s, 1980’s
  + Monetarist Point of View – not perfect
  + Supply-Side Policies/Demand side