Monetary Policy and the Federal Reserve

Wednesday, April 13, 2016 1:09 PM

The Federal Reserve

- Stabilizing policies are government policies that are meant to influence planned aggregate expenditure, with the goal of eliminating output gaps
    - Monetary policy, which can be changed quickly by a decision of the Federal Reserve's Federal Open Market Committee, is more flexible and responsive
    - Fiscal policy can only be changed by Congress
- The Federal Reserve is the central bank of the United States
    - Responsible for monetary policy
    - Oversight and regulation of financial markets
- 12 regional Federal Reserve banks each with a Federal Reserve district
- Board of Governors: the leadership of the Fed, consisting of seven governors appointed by the president to staggered 14-year terms
- Federal Open Market Committee (FOMC): the committee that makes decisions concerning monetary policy
- Banking Panic: a situation in which news or rumors of the imminent bankruptcy of one or more banks leads bank depositors to rush to withdraw their funds
    - Happen due to fractional-reserve banking, where bank reserves are less than deposits
    - Banks do not have enough cash on hand to pay off depositors if they were all to withdraw at one time
    - Greatly reduces nation's money supply
- The Fed can make loans to banks so that during a panic, banks can borrow cash from the Fed to pay off depositors
- Each extra dollar of bank reserves translates into several dollars of money supply
    - Each dollar can "support" several dollars in bank deposits
    - Public's withdrawals from banks, which increased currency held by the public but reduced reserves by an equal amount, led to a net decrease in the total money supply
        - Currency + deposits
- Bank deposits = Bank reserves/desired reserve to deposit ratio