BA 311 – Money and Banking

STRUCTURE OF THE FED

- 12 Regional Banks (ours is in SF – Region 12 with branch office in Seattle)
- Board of governors – appointed by POTUS, conformed by Senate.
- Independent of politicians thereafter (theoretically). Why?

MONETARY BASE (FED)

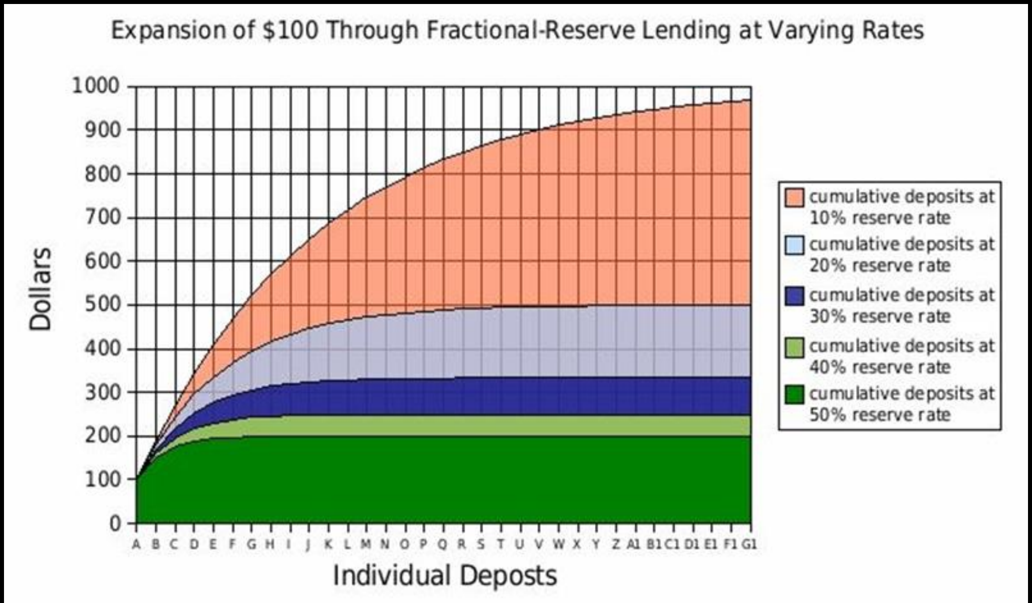
- The Fed controls the amount of currency in circulation plus the bank reserve requirement. This is the "monetary base".
- The Fed impacts the monetary base through "Fed Open Market Operations" – securities sales or purchases.
- Fed also impacts money supply through the "discount window" – discount loans to banks.
- Fed assets are the bonds purchased and loans made to banks. Fed liabilities is the monetary base (currency plus bank reserves)

MONETARY BASE (BANKS)

- Money supply is the currency in circulation plus checking deposits.
- Money is "created" by deposits going into a bank, the bank lends out the deposits, that money is spent and deposited, and so on. The reserve requirement at each level causes "leakage"

MONEY SUPPLY

- The money supply can be calculated based on the currency to deposit ratio, and the reserve ratio. https://en.wikipedia.org/wiki/Money_multiplier



MONEY SUPPLY

- Rise in Monetary Base increases money supply. Rise in currency to deposit ratio decreases the multiplier and therefore the supply. Why?
- Bank panics cause people to pull out cash from the banks. What does that do to the currency to deposit ratio?
- One of the major causes of the Depression – money "disappeared"

MONETARY POLICY TOOLS

- If Fed controls the money supply, how can they prevent the next Depression? How did they in 2008?
- Open Market operations. Buy $1,000 in bonds results in potentially $10,000 in money creation (if 10x multiplier)
- Change Discount Rate to encourage borrowing
- Change reserve requirements
- Change interest paid on reserves

MONETARY POLICY

- Fed targets interest rates and adjusts the money supply to achieve a certain rate level
- Primary target is the Fed Funds rate – the rate for an overnight loan between banks.
- Similar system in Europe uses LIBOR. Sometimes US loans are denominated in LIBOR. LIBOR is NOT set by central banks.
- FOMC meets every 6 weeks to review economic data and set interest rate targets.
- FOMC then directs Fed to use the Open Market levers to adjust money supply to hit the interest rate target.