Federal Reserve

by Sophia

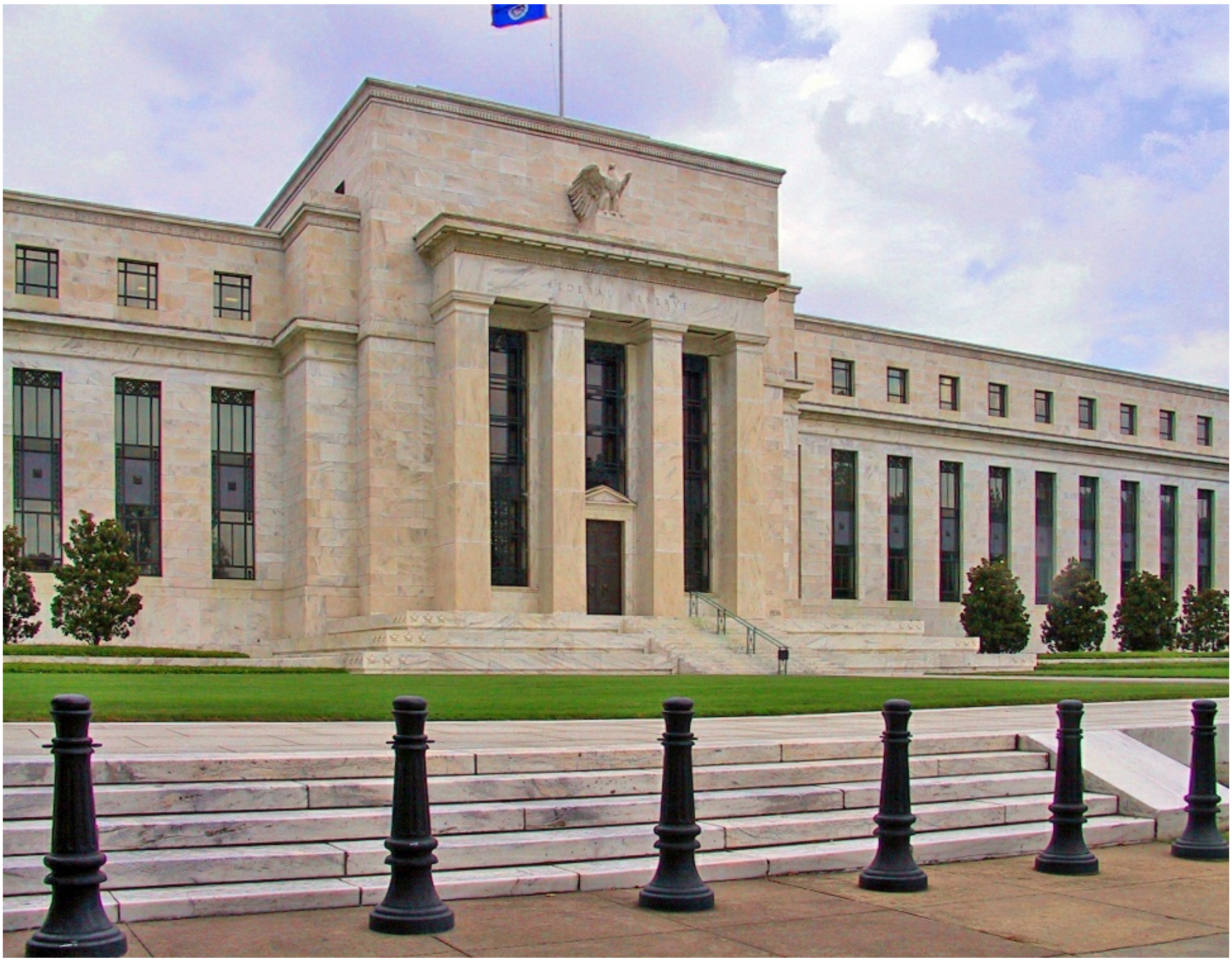
WHAT'S COVERED

What exactly is the Federal Reserve, or "the Fed?" You may have heard references to it on the news, but what is it? What does it do? This tutorial will cover the Federal Reserve. Our discussion breaks down as follows:

1. Purpose of the Federal Reserve

In the United States of America, the **Federal Reserve** is the governing bank, which includes 12 areas within the USA.

The purpose of the Fed is to observe changes in the money supply within the country. It also monitors inflation and works to keep the money supply constant and steady—not too high and not too low. The goal is to keep inflation at a manageable pace, and the ultimate goal is to ensure that the economy of the United States remains healthy.



TERM TO KNOW

Federal Reserve

In the United States of America, this is the governing bank; which includes 12 areas within the USA.

2. History of the Federal Reserve

The Federal Reserve was formed in 1913, and it covers 12 administrative areas within the United States.

There are seven members on the board, appointed by the President, and they serve in overlapping 14-year terms. These are the people who make up the Federal Reserve Bank, which is commonly referred to as the Fed. The Chairman of the Federal Reserve advises the United States on economic policies.

3. Role of the Federal Reserve

The Federal Reserve is the bank for the U.S. government. It oversees the printing of money and issuing of bonds to help raise capital for the government.

It also serves as the bank for all other banks in the United States, where they can borrow money to help stay within the rules and comply with the guidelines that the Federal Reserve puts in place.

Historically, the Fed also helped with check clearing, but because of current electronic check clearing, it doesn't really take care of that anymore.

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4. Tools of the Federal Reserve

The Fed has several tools at its disposal in order to keep the U.S. economy healthy.

- *Reserve requirements:* This is the amount of money that banks must hold in cash or deposits. The more money a bank has to hold, the less money is in the supply within the United States. Vice versa, the less money a bank has to hold, the more money is in circulation and available for use by the general public.

  What this means is that if you try to borrow money to buy a car, for example, or a business tries to borrow money for a business expense, there is less money available that you or the business is able to access. This, in turn, drives up interest rates and raises the value of money. In addition, the less supply of money there is in the general environment, the more valuable that money is going to be. Therefore, it's going to be more expensive to do things.

  BIG IDEA

  Higher requirement means that it will be harder for consumers to borrow money since banks have less money to lend.

- *Discount rate controls:* This is the rate at which banks borrow money from the Fed. The higher the rate a bank has to pay, the less money the bank will tend to lend out--and, it follows, the less money that will be available in the supply chain for general use. Conversely, the lower the rate the bank has to pay, then the more money they'll be able or willing to lend out in the form of loans, and more money will be available for general use.

  This directly impacts businesses, because a higher rate is going to mean that banks will have less money to lend out, and they'll also be less willing to lend that money. Therefore, it will be harder and more expensive for businesses to borrow money.

  BIG IDEA

  Higher bank rates means that it is harder to borrow money because it might be more expensive.

SUMMARY

Today we discussed an overview of the Federal Reserve. We learned about the **purpose of the Federal Reserve**, as well as the **history of the Federal Reserve**, or the Fed. We learned about the **role of the Fed** in the U.S. economy, managing the economy to make sure it stays healthy. Lastly, we learned about the **tools of the Fed** that it uses in order to maintain the health of the economy, such as setting the discount rate controls and reserve requirements.

Good luck!

Source: adapted from sophia instructor james howard

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