Name: ______________________________________ Date: ____________________ Block _______ # _______

Economics
Guided Reading – Unit 4, Day 4

Chapter 16–Federal Reserve and Monetary Polcy

Section 1 –The Federal Reserve System

Directions Following the page and heading prompts to read your Economics textbook assigned pages and write in the missing words or phrases. Answer all questions in complete sentences.

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Section Focus

To ___________________________ the nation's banking system, Congress created the Federal Reserve System in 1913. The Federal Reserve is _________________ by individual member banks. It is overseen by a small but powerful Board of Governors. As a _______________________ institution serving a public function, the Federal Reserve is a central bank relatively _________ from government control.

The America n banking system is a compromise between supporters and opponents of a central bank. As a symbol of this compromise, the Federal Reserve System is the privately owned, publicly controlled ____________________________ of the United States.

Federal Reserve Act of 1913

Congress created the National Monetary Commission (NMC) in 1908 to propose solutions to the nation's banking problems. Based on the NMC's recommendations,Congress passed the ____________________________________ in 1913. The resulting Federal Reserve System, now often referred to simply as "the Fed," was composed of a group of twelve _________________ regional banks. This central group of banks could ________________ to other banks in times of need.

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A Stronger Fed

In 1935, Congress adjusted the Federal Reserve's structure so that the system could ___________________ more effectively to future crises. These reforms created the Federal Reserve System as we know it today. The new Fed enjoys more centralized power so that the regional banks can act consistently with one another while still representing their own districts' banking concerns.

Structure of the Federal Reserve

Member banks themselves ________ the Federal Reserve System. Like so many American institutions, the structure of the Federal Reserve System represents _______________________ between centralized power and regional powers. (See Figure 16.1.)

The Board of Governors

The Federal Reserve System is overseen by the ___________________________________ of the Federal Reserve. The Board of Governors is head- quartered in Washington, D.C. Its seven members are _______________________ for staggered fourteen-year terms by the__________ of the United States with the advice and consent of the Senate. The terms are staggered to prevent any one President from appointing a full Board of Governors and to protect board members from day-to-day ______________________________. Members cannot be reappointed after serving a full term. Geographical restrictions on these appointments ensure that no one district is over-represented.

The _______________________________, from among these seven members, the ______________ of the Board of Governors. The Senate confirms the appointment. Chairs serve four-year terms, which can be renewed. The chair acts as the main _________________________ for monetary policy for the country. _____________________________ refers to the actions the Fed takes to influence the level of real GDP and the rate of inflation in the economy.

Twelve District Reserve Banks

The Federal Reserve Act divided the United States into twelve ___________________________________, as shown on Figure 16.2. One Federal Reserve Bank is located in, each of the twelve districts.

Each Federal Reserve Bank monitors and reports on ________________________ and _____________ conditions in its district. Each Federal Reserve District is made up of more than one state. The Federal Reserve Act aimed to establish a system in which no one region could _______________ the central bank's power at another's expense.

Member Banks

All nationally chartered banks are required to _____________ the Federal Reserve System. The remaining members are state-chartered banks that join __________________________. Since 1980, all banks have equal access to Fed services like check clearing and reserve loans, whether or not they are Fed members.

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Each of the approximately 4,000 Fed member banks contributes a small amount of _____________ to join the system. In return, they receive ________________ in the system. This stock earns them ____________________________ from the Fed at a rate of up to 6 percent.

The Federal Open Market Committee

The _________________________________ **(FOMC)** makes key decisions about ______________________ and the growth of the United States ____________________ supply. The committee meets about eight times a year in private to discuss the cost and availability of credit, for business and consumers, across the country. Announcements of the FOMC's decisions can affect the _____________________ markets, the rates for home mortgages, and many other economic institutions around the world. You will read more about the effects of monetary policy later in this chapter.

After meeting with the FOMC, the ______________ of the Board of Governors announces the committee's decisions to the public. The Federal Reserve __________________ and financial markets spring into action as they react to Fed decisions. In the next section, you will read about how the Fed's decisions are carried out and what functions the Federal Reserve serves.

Chapter 16–Federal Reserve and Monetary Policy
Section 2 – Federal Reserve Functions

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Section Focus
The Federal Reserve functions as the government's ________________ and as a ______________________. It __________________________ the nation's banking system. It also monitors and regulates the nation's money supply.

As the central bank of the United States, the twelve ________________ banks that make up the core of the Federal Reserve System carry out several important functions. The Federal Reserve System does the following:

- provides banking and fiscal services to the _______________________ government
- provides banking services to ________________________ and nonmember banks
- ____________________________ the banking industry
- tracks and manages the national ___________________________ to meet current demand and to stabilize the economy

Chapter 16–Federal Reserve and Monetary Policy
Section 3 – Monetary Policy Tools

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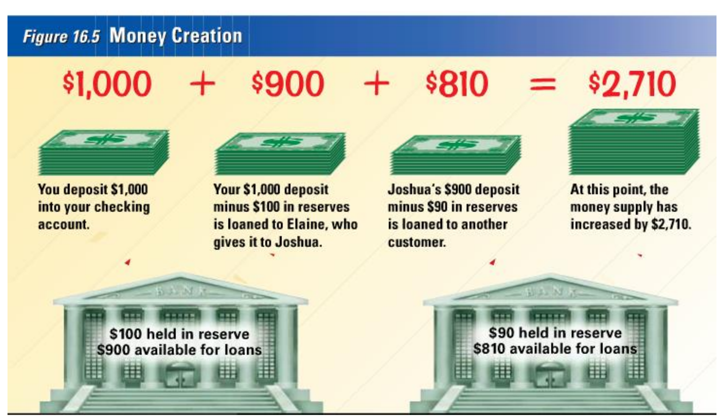
Section Focus
Banks __________________________ money in their day-to-day operations. The Federal Reserve uses the tools of _______________________ policy to control the amount of money in circulation.

Money Creation
The Department of the Treasury is responsible for ___________________________________ money. The Federal Reserve is responsible for putting dollars ________________________________. How does this money get into the economy? The process is called money creation, and it is carried out by the Fed and by banks all around the country.

How Banks Create Money
________________________________ does not mean the printing of money. Banks create money not by printing it, but by simply going about their business.

For example, suppose you take out a ____________ of $1,000. You decide to deposit the money in a checking account. Once you have deposited the



money, you now have a balance of $1,000. Since demand deposit account balances, such as your checking account, are included in MI, the money supply has now increased by $1,000. The process of money creation begins here.

Banks make money by ______________________________ on loans. Your bank will __________ part of the $1,000 that you deposited. The amount that the bank is allowed to lend is determined by the ____ (RRR)- the fraction of the deposit that must be kepton reserve. This is calculated as the ratio of reserves to deposits. The RRR is the ___________________ of deposits that banks are requiredto keep in reserve. The required reserve ratio, which is established by the FederalReserve, ensures that banks will have ________________________________ to supply customers' withdrawal needs.

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Setting Rates

As you read in Section 2, the ___________________________________ is the interest rate that the Federal Reserve charges on loans to financial institutions.

In the past, the discount rate was changed to ____________________ or ___________________ the money supply. Today, the discount rate is primarily used as a mechanism to insure that ___________ _____________________ are available in the economy. Forexample, during a financial crisis, there may not be enough funds available in the banking system to provide the necessary ___________ to businesses and individuals. In thatcase, the ability of banks to ________________ at the discount rate from the Federal Reserveprovides an important safety valve.

Today, when the Federal Reserve makes its decisions on monetary policy, it does so by setting a target for the _____________________________ rate, which is the rate that banks lend _____________ to one another. The Federal Reserve keeps the discount rate _____________ the funds rate. Banks will ____________________ borrow from one another at the federal funds rate. But if they need additional funds, they will turn to the Federal Reserve and borrow at the discount rate.

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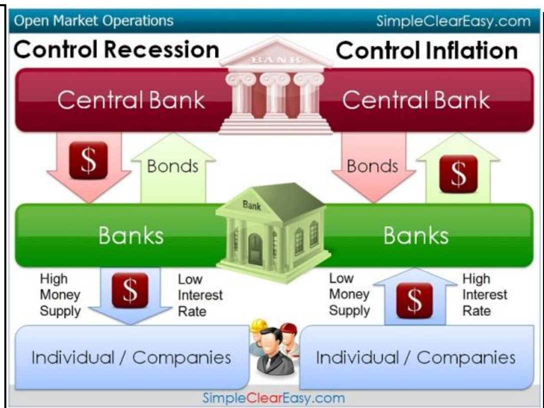
Open Market Operations

The most important monetary policy tool is __________________________________. Open market operations are the buying and selling of government _____________________ to alter the ___________________ of money. Open market operations are by far the most-used monetary policy tool.

Bond Purchases

When the Federal Open Market Committee (FOMC) chooses to ___________________the money supply, it orders the tradingdesk at the Federal Reserve Bank of New York to _______________ a certain quantity of government securities on the open market. The Federal Reserve Bank buys these securities with a check drawn on Federal Reserve funds. The bond seller then deposits the money from the _____________ sales in its bank. In this way, funds enter the banking system, setting in motion the __________________________ process described earlier.



Bond Sales

If the FOMC chooses to _____________________ the money supply, it must make an open market bond sale. In this case, the Fed ________ government securities back to bond dealers, receiving from them checks drawn on their own banks. After the Fed processes these checks, the money is out of circulation. This operation ____________ reserves in the banking system. Banks reduce their outstanding loans in order to keep reserves at the required levels.

Using Monetary Policy Tools

Open market operations are the _____________________________ of the Federal Reserve's monetary policy tools. They can be conducted smoothly and on an ongoing basis to meet the Fed's goals. The Fed changes the _____________________________ less frequently. It usually follows a policy of keeping the discount rate in line with other interest rates in the economy in order to prevent excess borrowing by member banks from the Fed.

Today, the Fed does not change ______________________________________ to conduct monetary policy. Changing reserve requirements would force banks to make drastic changes in their plans. Open market operations or changes in the discount rate do not ________________ financial institutions.

The Federal Reserve uses these monetary policy tools to adjust the money supply. Why the Fed would want to change the money supply, and the effects of monetary policy, are the subjects of the next section.

Chapter 16–Federal Reserve and Monetary Policy

Section 4 – Monetary Policy & Macroeconomic Stabilization

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Section Focus

The Federal Reserve uses monetary policy to try to tame ______________________________. The unpredictable length of business cycles, however, makes it difficult to intervene in the economy.

How Monetary Policy Works

Monetary policy alters the _____________________ of money. The supply of money, in turn, affects ____________________________. As you read earlier, interest rates affect the level and spending in the economy.

Part Two

Vocabulary Exploration

Using your textbook 'Economics Principles in Action' look up the following words/phrases and write in their complete definition.

Word/Phrase	**Complete Definition**
Board of Governors	
Monetary Policy	
Check Clearing	
Federal Funds Rate	
Discount Rate	
Net Worth	
Money Creation	
Prime Rate	
Required Reserve Ratio	
Prime Rate	
Open Market Operations	