

Economics Chapter 13 – The Federal Reserve System

1. **Board of Governors** – the governing body of the Federal Reserve System
2. **Federal Open Market Committee (FOMC)** – the 12 member policymaking group within the Fed. This committee has the authority to conduct open market operations
3. **Federal Open Market Committee** – 7 members of the Fed Reserve Board + 5 of the 12 district bank presidents
 - a. The Chairman (Alan Greenspan in 2002) sets the agenda of the meetings. He has more power than his single vote. Think House of Representatives Rules committee
4. **Open Market Operations** – the buying and selling of government securities by the Fed
5. The Federal Reserve system controls the money supply, supplies the economy with paper money, provides check clearing services, holds depository institutions' reserves, supervise member banks, serve as the government's banker, serve as the lender of last resort, and serve as a fiscal agent for the Treasury
6. **US Treasury Securities** – bonds and bondlike securities issued by the US Treasury when it borrows
7. If the people always hold a constant currency to deposit ratio k , when the deposits of the banks expand due to the Fed buying bonds, then the currency that people are carrying around is also more
8. **Monetary Base** – the sum of reserves and currency held outside banks. The Fed can control both the reserves (by buying bonds) and the currency that people are carrying around (since the deposits go up when they buy bonds, this goes up also), the Fed can control the Monetary Base in the economy
9. Checks deposited can end up either as a deposit at the Fed or as currency outside a bank
10. **Money Multiplier** – measures the actual change in the money supply for a dollar change in the monetary base
 - a. Money multiplier = money supply / Monetary Base
 - b. Money Supply = Monetary Base * Money multiplier
11. **Reserve Requirement** – the rule that specifies the amount of reserves a bank must hold to back up deposits
12. **Federal Funds Market** – a market where banks lend reserves to one another, usually for short periods
13. **Federal Funds Rate** – the interest rate in the federal funds market; the interest rate banks charge one another to borrow reserves
14. **Discount Rate** – the interest rate the Fed charges depository institutions that borrow reserves from it
15. The Fed prefers to use open market operations to control the money supply because they are flexible, and can be bought or sold in small or large amounts. They are also easily reversed, either with buying or selling or vice versa. Finally, they can be implemented quickly. The trade of securities is immediate, and does not have a lag time

Added 11/16/02

1. **Currency to deposit ratio** – the proportion of currency that people want to hold relative to their deposits
 - a. **Currency to deposit ratio** - currency / deposits
2. **Relationship between money supply and monetary base**
 - a. **Terms Required**
 - i. **Money supply** – deposits + currency, signified by M
 - ii. **Currency** – money that's in people's pockets as cash, signified as CU
 - iii. **Currency to deposit ratio** – the % of deposits that people in general carry, signified by k
 - iv. **Deposits** – the amount of money that the bank owes to people, or the amount of money that the people deposit in the bank. Signified as D
 - v. **Monetary Base** – the sum of reserves and currency, signified as MB
 - vi. **Reserves** – money that banks hold at the fed, signified as BR
 - b. **Money Multiplier** – the value $(k + 1) / (r + k)$. It's the value that you multiply the monetary base by to get the money supply
 - c. **Derivation of the money multiplier**
 - d. **Statements**

<ol style="list-style-type: none"> e. $MB = CU + BR$ f. $CU = kD$ g. $M = CU + D$ h. $BR = rD$ i. $M = kD + D$ j. $M = D(k + 1)$ k. $MB = kD + rD$ l. $MB = D(k + r)$ m. $M/MB = (k + 1) / (r + k)$ 	Reasons By Definition By Definition By Definition By Definition Substitution, line f into line g Factor out D from line i Substitution, lines f and h into line e Factor out D from line k Divide line j by line l
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