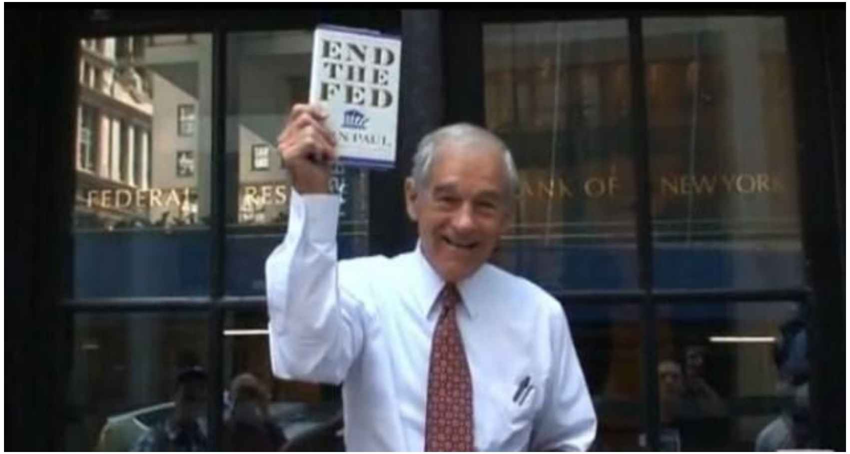
**Teach-In**

# The Federal Reserve and Interest Rates

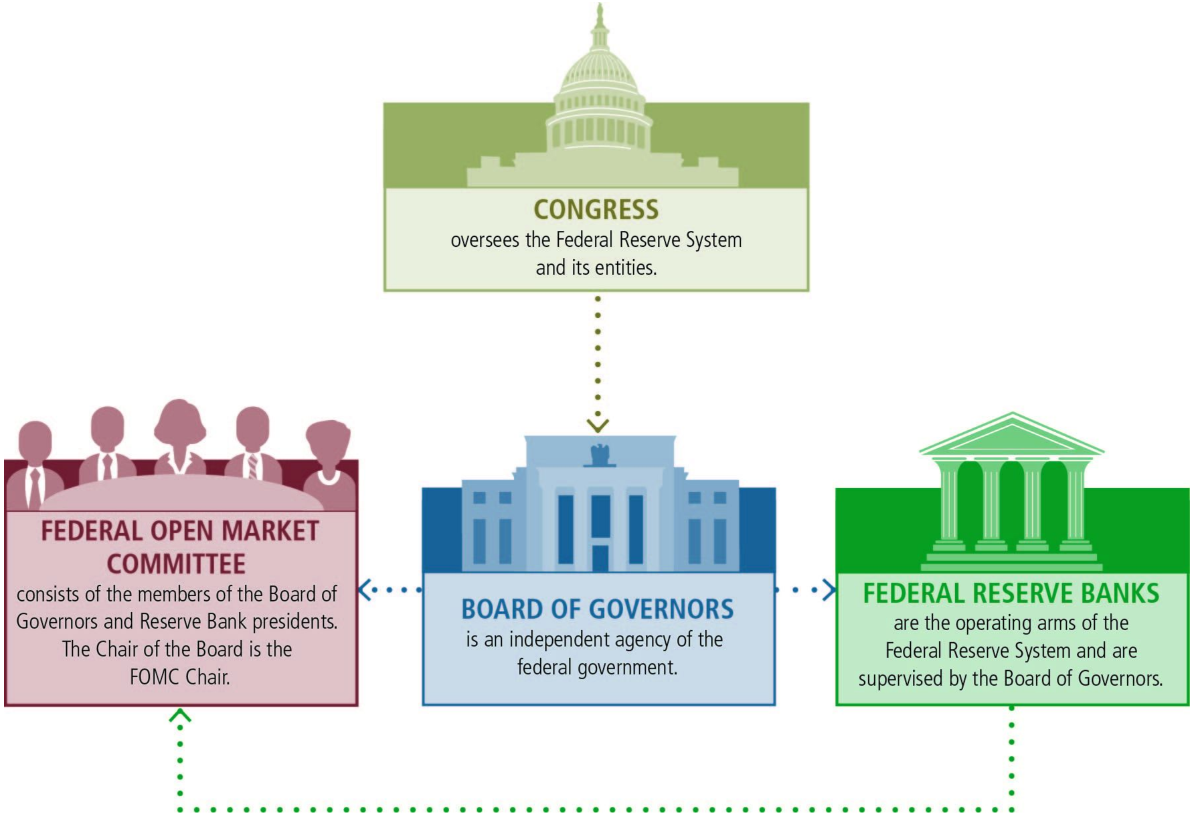
# What is the Fed?

- The Federal Reserve is the central bank of the United States of America

- The Fed is responsible for…
  - **Setting interest rates**
  - Supervising and regulating financial institutions
  - Serving as the bank for banks
    - **Lender of last resort**

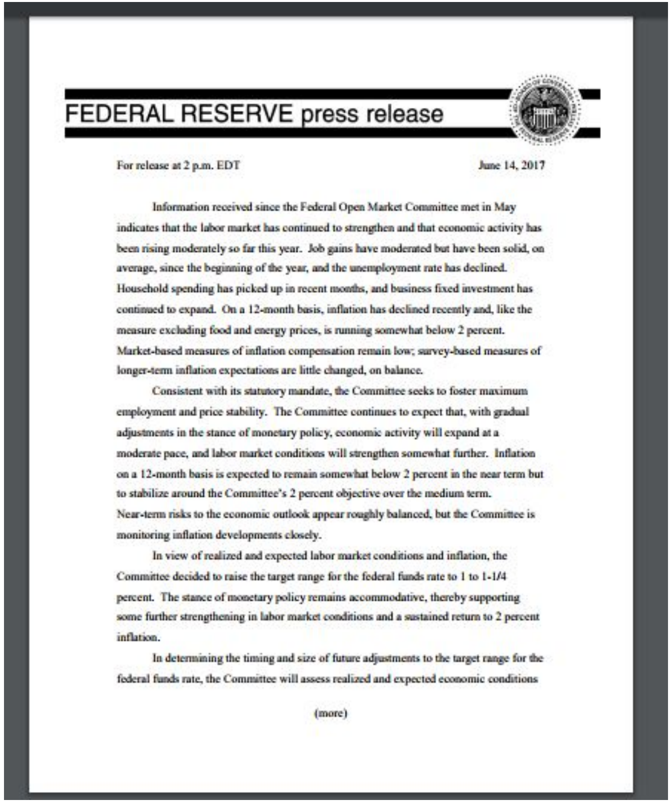


# Structure


CONGRESS
oversees the Federal Reserve System and its entities.
FEDERAL OPEN MARKET COMMITTEE
consists of the members of the Board of Governors and Reserve Bank presidents. The Chair of the Board is the FOMC Chair.
BOARD OF GOVERNORS
is an independent agency of the federal government.
FEDERAL RESERVE BANKS
are the operating arms of the Federal Reserve System and are supervised by the Board of Governors.

# Federal Open Market Committee

- Consists of 12 members...
  - Federal Reserve Board of Governors
  - NY Fed President
  - Rotation of other Fed Presidents
- Body that sets interest rates and dictates other monetary policy
- **¡¡Adhere to their Dual Mandate!!**
  - *Maximize Employment*
  - *Maintain Price Stability*



FEDERAL RESERVE press release

For release at 2 p.m. EDT June 14, 2017

Information received since the Federal Open Market Committee met in May indicates that the labor market has continued to strengthen and that economic activity has been rising moderately so far this year. Job gains have moderated but have been solid, on average, since the beginning of the year, and the unemployment rate has declined. Household spending has picked up in recent months, and business fixed investment has continued to expand. On a 12-month basis, inflation has declined recently and, like the measure excluding food and energy prices, is running somewhat below 2 percent. Market-based measures of inflation compensation remain low; survey-based measures of longer-term inflation expectations are little changed, on balance.

Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee continues to expect that, with gradual adjustments in the stance of monetary policy, economic activity will expand at a moderate pace, and labor market conditions will strengthen somewhat further. Inflation on a 12-month basis is expected to remain somewhat below 2 percent in the near term but to stabilize around the Committee's 2 percent objective over the medium term. Near-term risks to the economic outlook appear roughly balanced, but the Committee is monitoring inflation developments closely.

In view of realized and expected labor market conditions and inflation, the Committee decided to raise the target range for the federal funds rate to 1 to 1-1/4 percent. The stance of monetary policy remains accommodative, thereby supporting some further strengthening in labor market conditions and a sustained return to 2 percent inflation.

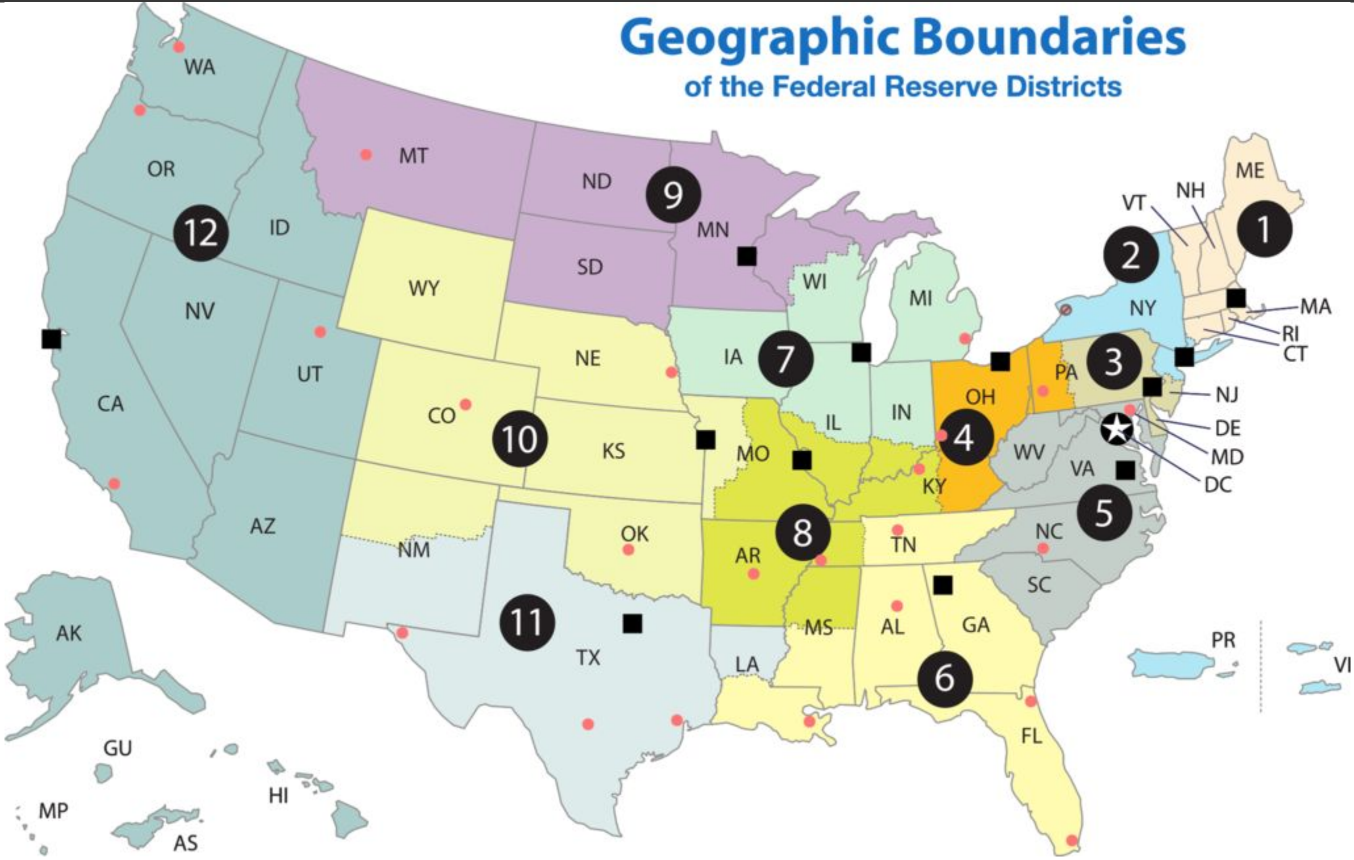
In determining the timing and size of future adjustments to the target range for the federal funds rate, the Committee will assess realized and expected economic conditions

(more)

# Economic Implications

- Lower interest rates (loose monetary policy)= lower borrowing costs= more investment + consumption
  - Increased economic growth → less unemployment
  - Increased consumption and less unemployment → Higher Inflation
    - High inflation can lead to hyperinflation
- Conversely, higher interest rates (tight monetary policy) can slow down the economy too much and cause too much unemployment

# Federal Reserve Banks



# Key Terminology

- Federal Funds Rate: The overnight rate at which banks lend money to other banks
  - Current Fed Funds Rate Range: 1.00%-1.25%
- Quantitative Easing (QE): The Fed's series of asset purchases from 2008-2014. The Fed purchased $4.5 trillion of USTs, MBSs, and Agency Debt
- Unwinding the Balance Sheet: Process by which the Fed will decrease its holdings of USTs, MBSs, and Agency Debt. Starting with $6B USTs & $4B MBSs/month.
- Hawkish: Monetary policy that is aggressively anti-inflation (tighter monetary policy)
- Dovish: Monetary policy that is less anti-inflation (looser monetary policy)

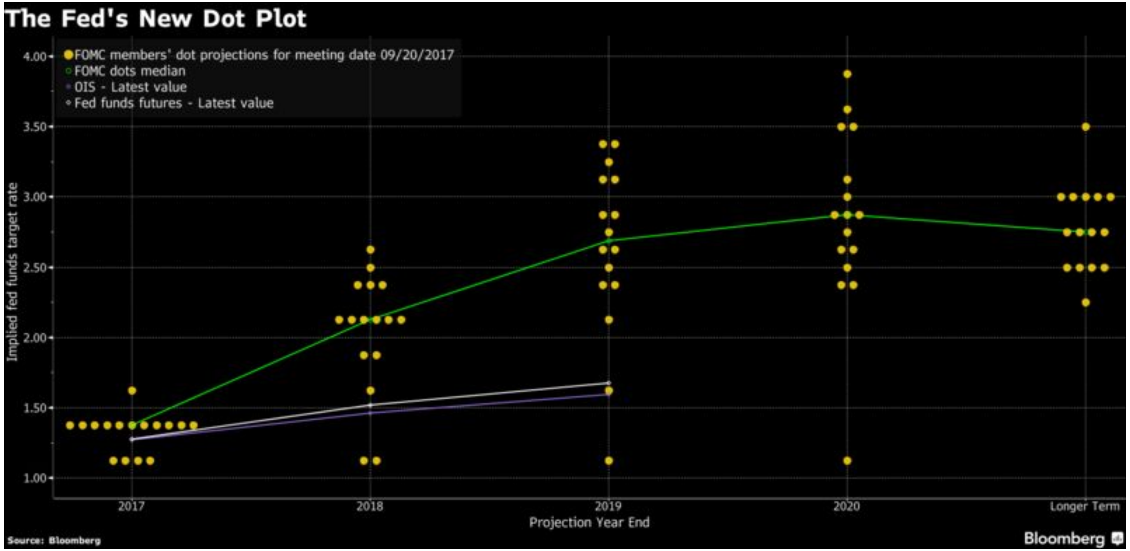
# Policy Making Tools

- Setting Interest Rates
  - **Federal Funds Rate**
  - Discount Rate
  - Repo Rate

- Forward Guidance

- Quantitative Easing

- Helicopter Money???



# Market Implications

- Lower interest rates= lower bond yields= higher bond prices
    - Who wins and who loses?
        - Winners: Owners of financial assets, workers, debtors
        - Losers: Creditors, banks, buyers of new bonds

- Higher interest rates= higher bond yields= lower bond prices
    - Who wins and who loses?
        - Winners: Creditors, banks, buyers of new bonds
        - Losers: Owners of of financial assets, workers, debtors

- All market participants are sensitive not just to Fed actions, but Fed sentiment and market expectations of future Fed action