



What is Money?

Very Liquid

Cash, checking/saving accounts, treasury bills, stocks and bonds...

Very Illiquid

human capital



What is Monetary Policy?

There are two components to monetary policy:

1. Setting interest rates (i)

Which ones? How?

2. Controlling the money supply (M)

How?



How Does the Fed Carry Out Monetary Policy?

It does NOT print money!!!

Least used



Most used

- 1. Reserve Requirements**
- 2. Discount Rate**
- 3. Open Market Operations**



Controlling the Money Supply – Reserve Requirement

Reserve Requirement (RR):

% of every dollar deposited that a bank must keep as reserves

This means that the remainder of each dollar deposited can be loaned to someone else



Controlling the Money Supply – Discount Rate

This is what everyone talks about when they say that the Fed is cutting interest rates

Discount rate = rate that banks can borrow reserves from the Fed



Controlling the Money Supply – Federal Funds Rate

Federal Funds Rate = rate that banks can borrow reserves from each other

Federal Reserve tries to influence the Fed. Funds rate through discount rate and open market operations.....



Controlling the Money Supply – Open Market Operations

Federal Reserve controls the money supply (M) directly and interest rates (i) indirectly.

THEY DON'T PRINT MONEY!!!!

To increase money supply:

Lower reserve requirements

To decrease money supply:

Increase reserve requirements