Describe the history of the federal reserve bank. include an explanation of all t...

[Finance](), [Banks]()

Introduction Federal Reserve Bank is one of the largest central banks in the world. Commonly known as FED, Federal Reserve Bank is the central bank of United States of America. Like every central bank, it performs some specific functions to expand and contract the monetary base of US and thus effectively is controlling and managing the monetary policy of US. This essay will explore the history of the formation of Federal Reserve Bank i. e. FED and will look into some of the methods it use to contract or expand the economy using money supply and interest rates.

History of FED

Early history of banking in United States suggest that during its nascent stage, Banking runs were common as many banks opened and faltered during small period of time. Based on the increase failures of financial institutions, Congress set up National Monetary Commission to look into it. Commission presented its first monetary reform plan to the Congress in year 1912. This plan recommended the establishment of National Reservations Association which would hold the reserves of commercial banks and could make short-term loans to banks to ensure credit availability. United States Congress responded to the situation by enacting Federal Reserves Act thus creating Federal Reserve System. President Woodrow Wilson endorsed these recommendations and Federal Reserves Act became a law on Dec 23, 1913 and FED was created (Federal Reserve Bank of Dallas).

The primary responsibility of FED is to manage the enough money supply and credit to sustain the economic growth of the country by containing inflation. The contraction and expansion of economy is thus achieved with the help of following two economic variables:

1) Money Supply: Expanding or contracting the economy through the money supply is the most frequent method used by FED to exercise its powers to make changes in the economy. Traditionally called Open market operations, these are the activities through which FED either purchase or mope up the excess liquidity from the economic system by issuing securities called T-Bills or Treasury Bills. Similarly when FED wants to expand the economy through money supply, it will purchase the issued T-Bills thus off loading hard currency in the market. This is done primarily for one purpose and that is that through this, FED wants to control the flow of money in the economy. The easy availability to the excess money may create inflation in the economy hence have the potential to impact the real growth in the economy.

2) Interest rates: FED controls the expansion or contraction in the economy through interest rates effectively in two ways. One is through making changes in the discount rate and other is through increasing or decreasing the interest rates on T-Bills to be issued by FED. Discount rate is the interest rate at which banks can borrow from the FED in case they require short term funding. By raising or decreasing the discount rate, FED basically makes borrowing more costly or less cheap hence restricting or expanding the flow of credit in the economy.

Conclusion

FED is one of the largest central banks in the world with primary mandate of managing the economy of United States by regulating monetary policy. The regulation of the monetary policy is done mostly through two methods of money supply and interest rates.

References

Federal Reserve Bank of Dallas. " History of the FED." 2008. Federal Reserve Bank of Dallas. 27 Feb 2008 .