The federal reserve and the financial crisis assignment

History

The book is very good written and it explains his ideas clearly. After each lecture there is a question and answer section and the book is basically divided into two parts. The first two provide a background to the last two lectures who focus on how the Fed dealt with the crisis and the recovery. The author starts by talking about the origins and evolution of central banks. He explains how the central bank is not a regular bank; it’s a government agency, and it stands at the center of a country’s monetary financial system.

There are exceptions where they have currency union, where a number of countries hare a central bank, like the European Central Bank that share the Euro as their common currency. He explains that central banks have two main missions; the first is to try to achieve macroeconomic stability and to maintain financial stability. The tools the central bank uses to achieve these two objectives. On the economic stability side, the main tool is monetary policy. They can raise or lower short-term interest rates by buying and selling securities in the open market.

The other tool for dealing with financial panics or financial crises is the provision of liquidity. In order to address financial stability concerns, one thing they do is make short term loans to financial institutions, these can help calm the market and its called “ lender of last resource”. There is a third tool that most central banks have, which is financial regulation and supervision. Trying to keep the financial system healthy so that the chance of a financial crisis occurring in the first place is reduced.

Central banks have been around for a very long time. The Swedes set up a central bank in 1668 and the bank of England was founded in 1694. He also

talks about how financial panic is sparked by a loss of confidence in an institution and panics can be very serious problems, if one bank is having problems, people at the bank next door may begin to worry as well. A financial panic can occur anytime you have an institution that has longer-term liquid assets and is financed on the other side of the balance sheet by shot term liabilities such as deposits.

The Federal Reserve was founded in 1914 and both concerns about macroeconomic stability and financial stability motivated this decision to create it. After the Civil War there was no entrap bank, so any kind of financial stability functions that could not be performed by the treasury had to be done privately. Financial panics in the U. S. Were a big problem in the period of the restoration of the gold stander after the Civil War in 1879 through the founding of the Federal Reserve. After the crisis Of 1907, Congress began to think that maybe they needed a government agency that could address the problem of financial panics.

So a 33-volume study was prepared for the Congress about Central banking practices, and Congress moved toward creating then a central bank in 1914. For most of the period from after the civil War until the 1 sass, the U. S. Was on gold standard, which is a monetary system in which the value of the currency is fixed in terms of gold. Unfortunately gold standard was far from a perfect monetary system. Volatility in output variability and year-to- year movements in inflation were much greater under the gold standard.

There were many things wrong with the gold standard; yet another one was the speculative attack, where banks only kept a fraction of the gold

necessary to back the entire money supply. The only thing about the gold standard was hat over long periods of time prices were quite stable. In the late 19th century, there was a shortage of gold relative to the economic growth and since there was not enough gold the U. S. Economy was experiencing deflation. So the gold stander created a lot of problems and was motivation for the founding of the Federal Reserve.

In 1 929 the world was hit by the first great challenge to the Federal Reserve, the Great Depression and unfortunately the Fed failed both on its monetary policy mission and on its financial stability mission. On the monetary policy side, the Fed did not ease monetary policy as you would expect it to in a period of deep recession and in its job of being lender of last resource it responded inadequately to the bank runs, essentially allowing a tremendous decline in the banking system as many banks failed, and as a result, bank failures swept the country.

When Roosevelt came he did two things that helped fix the problems cause by the Feds. One was the establishment of deposit insurance and the other one was abandoning the gold standard for good. The Federal Reserve failed in their first challenge in both pars of its mission but these lessons are going to e carried away trough time. Some of the things they learned from were that they didn't use monetary policy aggressively to prevent deflation and it didn't perform adequately its function as a lender of last resort.

The congress revised the Federal Reserve Act approved in 1913 to lessen the independence of the Reserve Banks and concentrate power in the Board of Governors in Washington. Nonetheless between asses t asses the Federal

Reserve was subservient to the Treasury. After the World War two, and a lot of struggle, the Fed was finally successful in its campaign to regain its independence to use its interest rate tools to fight inflation. In the 1 ass's and sass's the Feud's primary concern was macroeconomic stability and there was a lot of growth occurring.

Starting in the mid sass's, monetary policy became too easy and this led to a wave in inflation that only got higher between 1965 and 1982. He said there was many factors for this Great Inflation, like the Feud's cooperation with the Treasury in funding debt and price controls. The author commends Paul Blocker for breaking the inflation strike with his policies from 1979 to 1982. This led to what Was known as the " great Moderation", which was a very real phenomenon in where both growth and inflation were more stable to a remarkable extent. Bracken's then starts talking about the Great Recession and the 2007 -?? 2008 financial crisis.

He talks about the mortgage crisis and the policies undertaken by the Fed to mitigate it. The crisis was a reflection of the vulnerabilities of the private sector, which were excessive debt, failure of banks to monitor risks, a lot of short-term funding, gaps in regulation, etc. The financial crisis of 2008 was not a normal banking crisis because it was centered in the non-bank financial yester. The collapse of Lehman led too massive global financial market panic and the Fed created special liquidity facilities to provide funding to the money markets.

Facilities for broker dealers, asset backed securities and many other institutions were created. Once the crisis was over, the author describes how

the tools of monetary policy were used to prevent a repeat of the Great Contraction. The Fed cut its federal funds rate aggressively in 2007 and then again in 2008 almost to zero. He says that under his watch in 2012 the Fed adopted a 2 percent inflation target and also commitment to keep monetary policy simulative until unemployment was reduced to the natural rate it was supposed to be.