The federal reserve

Money and the Federal ReserveJennifer BeckerECO/2124/27/10Leander WoodsMoney and the Federal ReserveNothing in live is free. When you go into a store with the intention of obtaining a new pair of shoes, the sales clerk working at the counter will be expecting money in return. Money is society??™s form of exchange for goods and services. Before money was introduced as a form of exchange, the bartering system was used. In the bartering system, one good or service is exchanged for another.

This system however, would be too difficult in today??™s economy with so many different types of goods and services. Money is defined as ??? the set of assets in an economy that people regularly use to buy goods and services from other people??? (Mankiw,? 2007,? p.? 642). Money has three functions in the economy: it is used as a medium of exchange, a unit of account, and a store of value. As in the shoe store example, money is used to exchange for a desired good or service.

Money is also used to measure economic value and record debt. Finally, money is used as a transfer of purchasing power from the buyer to the seller. When purchasing that pair of shoes, you are giving up your money in exchange for the item therefore transferring the purchasing power to the store owner. Banks also play an important role in the monetary system. The Federal Reserve is the central bank of the United States. Created in 1913, The Federal Reserve, or the Fed, oversees the banking system and controls the amount of money in circulation. The Fed is managed by the board of governors, consisting of seven members selected by the president to a fourteen year term.

The chairman is the head to the board of governors but unlike the board members, the chairman??™s term is only four years. The Federal Reserve Board is located in Washington D. C.

and twelve other Federal Reserve Banks are located in major cities around the country. The Fed controls the quantity of money in circulation by the purchase and sale of US bonds to increase money supply, and the selling of government bonds in the nation??™s bond markets to decrease the supply. Reserve requirements also exist to help regulate money supply. These requirements determine the amount of reserves that banks must hold. For example, when the reserve ratio is increased, the banks are required to hold onto more money and can loan less out.

The banks themselves will occasionally need to borrow money if their reserve levels are too low to meet the reserve requirements, so in this situation the Fed will step in and loan the banks money at a low interest rate. The Federal Reserve has been especially concerned recently in the stabilization of the money supply. In his monetary report to Congress, the current chairman of the board of governors, Ben Bernake (2010) addressed current monetary polices and their effects: The Federal Reserve continued to support the functioning of financial markets and promote recovery in economic activity using a wide array of tools.

The Federal Open Market Committee (FOMC) maintained a target range of 0? to 1/4? percent for the federal funds rate throughout the second half of 2009 and early 2010 and indicated that economic conditions were likely to warrant exceptionally low levels of the federal funds rate for an extended period. Further, the Federal Reserve continued its purchases of Treasury securities, agency mortgage-backed securities (MBS), and agency debt in order to provide support to mortgage and housing markets and to improve overall conditions in private credit markets. (para. 9) For the purpose of putting a downward pressure on short term interest rates and therefore increasing the money supply, the Fed is continuing to purchase Treasury securities. Money supply is also increased by the low discount rates applied to the financial institutions that were in need of borrowing extra funds.

This injection of money into the economy and lowering of interest rates may help restore consumer confidence and therefore stimulate the economy, but what does this mean for employment As more consumers return to the market, demand for goods and services will rise and so will inflation. The Phillips curve shows that there is a trade-off between inflation and unemployment. When unemployment is high (as it is today) inflation is low but as inflation rises, unemployment lowers. In conclusion, the monetary policy of increasing money supply is positive for economic recovery as inflation is sure to rise and unemployment should lower. ConclusionMoney is a necessary medium of exchange for goods and services. The amount of money circulating in the economy has an effect on its value. When too much money is in circulation, the money value depreciates.

Conversely, if money is in more limited supply, its value appreciates. The Federal Reserve or, the Fed is the central bank of the United States. The Fed controls the money supply by the purchase and sale of bonds, the reserve requirements for the banks, and the discount rate at which the Fed gives loans as a last resort to financial institutions in trouble. These monetary policies can affect economic stability and the unemployment rate.

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