LIGHTHOUSE CPA SOCIAL SCIENCES DEPARTMENT

AP ECONOMICS

STUDY GUIDE # 19 - FEDERAL RESERVE AND
*   MONETARY POLICY*

CHAPTER LEARNING OBJECTIVES

1.   STUDENTS WILL BE ABLE TO IDENTIFY WHO OWNS THE FEDERAL RESERVE SYSTEM AND ITS STRUCTURE

2.   STUDENTS WILL BE ABLE TO DESCRIBE THE STRUCTURE OF THE FEDERAL BOARD OF GOVERNORS AND THE 12 FED DISTRICTS

3.   STUDENTS WILL BE ABLE TO DESCRIBE AND EXPLAIN THE ROLES OF THE FEDERAL ADVISORY COUNCIL AND THE FEDERAL OPEN MARKET COMMITTEE

4.   STUDENTS WILL BE ABLE TO IDENTIFY AND EXPLAIN THE FUNCTIONS OF THE FEDERAL RESERVE BANK IN SRERVING THE GOVERNMENT OF THE UNITED STATES, SERVING IST REGULATING MEMBER BANKS, AND REGULATING THE MONEY SUPPLY

5.   STUDENTS WILL BE ABLE TO EXPLAIN THE DIFFERENCE BETWEEN FISCAL AND MONETARY POLICY

6.   STUDENTS WILL BE ABLE TO IDENTIFY AND EXPLAIN THE TOOLS FOR MANAGING MONETARY POLICY

7. STUDENTS WILL BE ABLE TO EXPLAIN THE CONCEPT BEHIND THE PHILOSOPHY OF MONETARISM, EASY MONEY POLICIES, AND TIGHT MONEY POLICIES

STRUCTURE OF THE FEDERAL RESERVE SYSTEM - 5 FACTS :
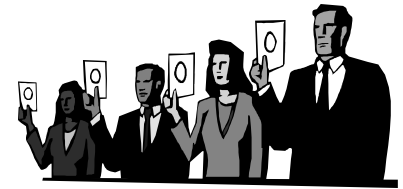
1.

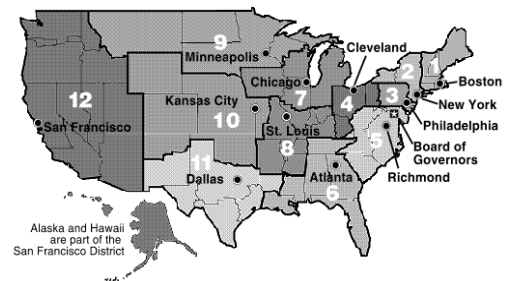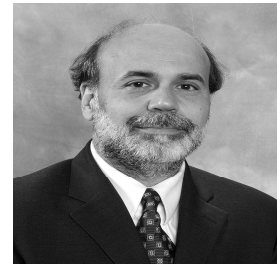   *1.*

    2.

    3.

2.

   1.

   2.

   3.

   4.

   5.

WHO IS CHAIRMAN OF THE FEDERAL RESERVE AND SECRETARY OF THE TREASURY ?

3.

   1.

   2.

   3.

4.   *" FEDERAL ADVISORY COUNCIL (FAC) " -*

5.   *" FEDERAL OPEN MARKET COMMITTEE (FOMC) " -*

   1.

   2.

   3.

WHAT ARE THE 4 FUNCTIONS OF THE FEDERAL RESERVE SYSTEM ?

1.

1.

2.

3.

2.

   1.

   2.

   3.

   4.

   5.

      1.   " *DISCOUNT RATE* " -

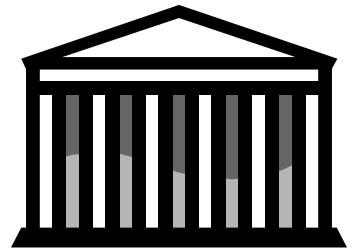   2.   " *FUNDS RATE* " -
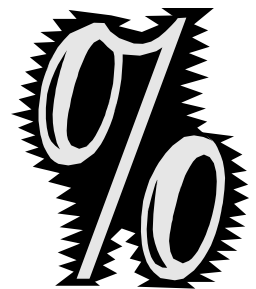
3.

   1.

   2.

      1.   2.   3

4.

    1.

    2.

    3.

    4.

MONETARY POLICY

WHAT IS THE DIFFERENCE BETWEEN FISCAL AND MONETARY POLICY ?

1.   *FISCAL POLICY -*

2.   *" <u>MONETARY POLICY</u> " -*

WHAT ARE THE 4 TOOLS THE FED HAS FOR MANAGING MONETARY POLICY ?
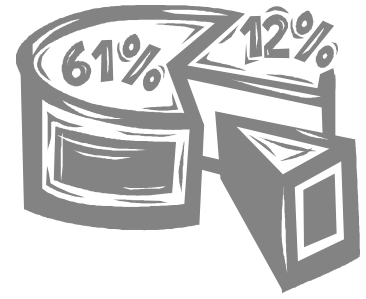
1.

    1.

    2.

    3.

2.   *" <u>RESERVE REQUIREMENTS</u> " -*

    1.

    2.

3.

        *1.   " **PRIME RATE** " -*

        2.

WHY DOES THE FED LIKE TO USE THE DISCOUNT RATE AS A MONETARY TOOL RATHER THAN THE RESERVE REQUIREMENT ?

*4.   " **OPEN MARKET OPERATIONS** " -*

        1.

        2.

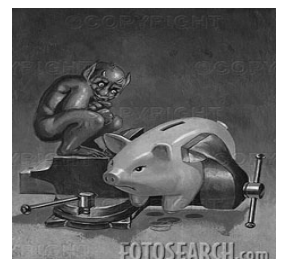*WHY DOES THE FED LIKE TO USE THE OPEN MARKET OPERATIONS TOOL THE MOST ?*

WHAT ARE THE 3 FUNDAMENTAL BELIEFS OF MONETARY POLICY ?

*1.   " **MONETARISM** " -*

*2.   " **EXPANSIONARY MONEY POLICY** " -*

        WHY IT WOULD BE USED ?

*3.   " **CONTRACTIONARY MONEY POLICY** " -*

WHY IT WOULD BE USED ?

SUCCESS IN COORDINATION MONETARY AND FISCAL POLICIES IS A MATTER OF TIMING > KNOWING WHEN AND HOW TO ACT > THERE ARE 3 THINGS TO CONSIDER :

1.   *" INSIDE LAGS " -*

        1.

        2.

2.   *" OUTSIDE LAGS " -*

3.

ILLUSTRATING THE IMPACT OF THE MONEY SUPPLY ON AGGREGATE SUPPLY AND DEMAND

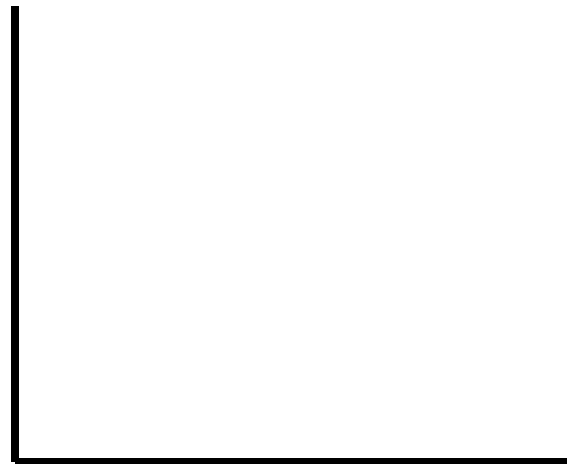*THE MONEY MARKET CHART*

THIS CHART IS USED FOR TWO THINGS :
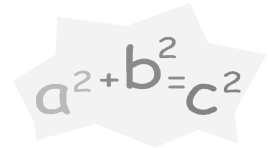
1.

        1.

        2.

        3.

2.

        1.

2.

3.

THREE IMPORTANT NOTES ABOUT THE " RESERVE REQUIREMENT " :

1.

2.

3.   IT DRIVES THE " <u>MONEY MULTIPLIER</u> " -

1.

2.

3.

MONETARY POLICY EXAMPLES :

RESERVE RATE REDUCTION TO <u>SPEED UP</u> THE ECONOMY :

DISCOUNT RATE REDUCTION TO <u>SPEED UP</u> THE ECONOMY

OPEN MARKET OPERATIONS TO <u>SPEED UP</u> THE ECONOMY

THE EFFECT THE ↓RR, ↓ DR, AND / OR THE PURCHASE OF BONDS WOULD HAVE ON DEMAND AND THEREFORE GDP

CAUTION ! BE ABLE TO RECOGNIZE THE SUBTLE DIFFERENCE BETWEEN AN "INCREASE" IN THE MONEY SUPPLY, VERSUS THE "TOTAL" MONEY SUPPLY .... EXAMPLE :

WHAT HAPPENS WHEN A LARGE FOREIGN DEPOSITOR COMES INTO THE COUNTRY ?

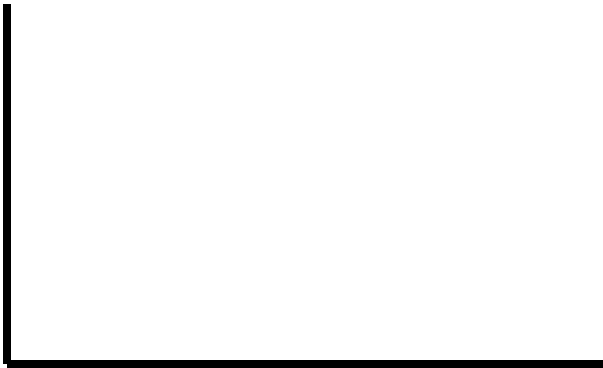*BE ABLE TO DISTINGUISH BETWEEN THE MONEY SUPPLY AND MONEY STOCK :*

    M 1

    M2

    M3

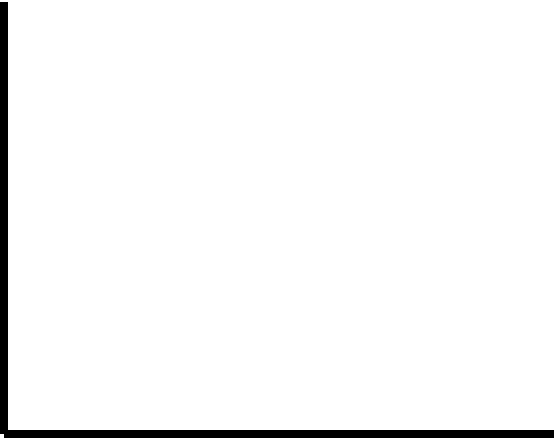*ILLUSTRATING EFFECTS OF COMBINED FISCAL AND MONETARY POLICY ON INTEREST RATES*

AS GOVERNMENT ……..

THE " FLIP " SIDE OF THE COIN IS ……..

THE LONG TERM EFFECTS ARE REFLECTED IN THE LOANABLE FUNDS MARKET :
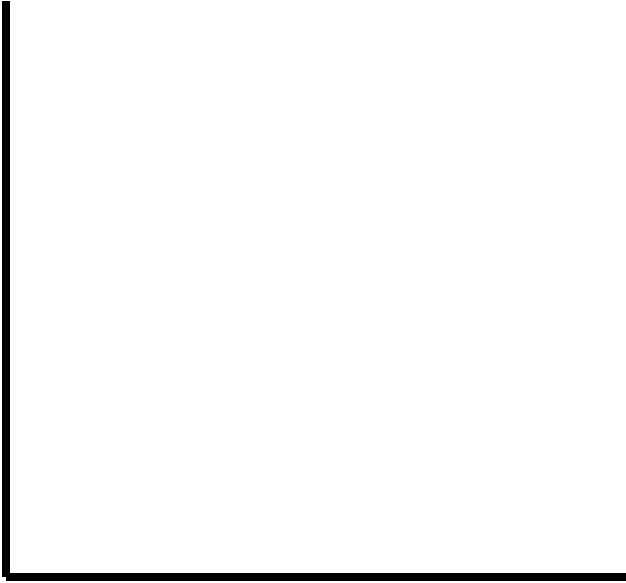
AP EXAM TIP !!!!

WHEN …..

WHEN …….

THE FEDERAL RESERVE WILL LIKELY …….

HOWEVER , NOTE THAT ANY HIGHER INTEREST RATES WILL CAUSE THE " CROWDING OUT EFFECT " -

ADVANCED CONCEPTS RELATING TO MONETARY TOPICS

" MONETARY NEUTRALITY " -

A DEBATABLE ……..

TO UNDERSTAND …….

" NOMINAL VARIABLE " -

" REAL VARIABLE " -

THE KEY TO ……..

NOMINAL VARIABLES ARE ………

REAL VARIABLES ARE ....

THE FISHER EFFECT

FIRST , IT IS A FACT ......

SECOND , BASED ON THE ....

THIRD , THE " FISHER EFFECT " -