

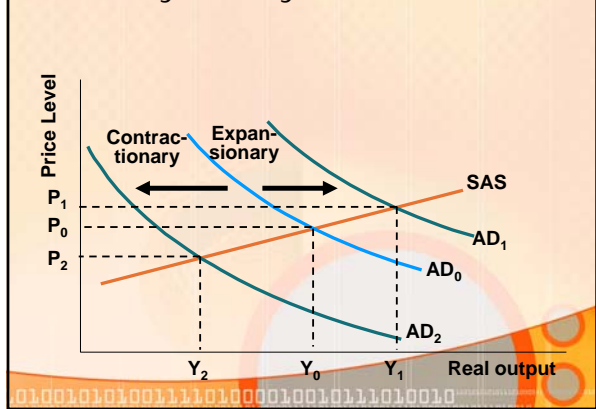
MONETARY POLICY AND THE DEBATE ABOUT MONETARY POLICY

Part one

Laugher Curve

A caveman points to two of his hairy relatives carrying clubs over their shoulders and says: "OK—you hunt, you gather, and I'll fine tune the economy."

Monetary Policy



Effect of Monetary Policy on the Macro Policy Model

- *Expansionary monetary policy shifts the AD curve to the right.*
- *Contractionary monetary policy shifts the AD curve to the left.*

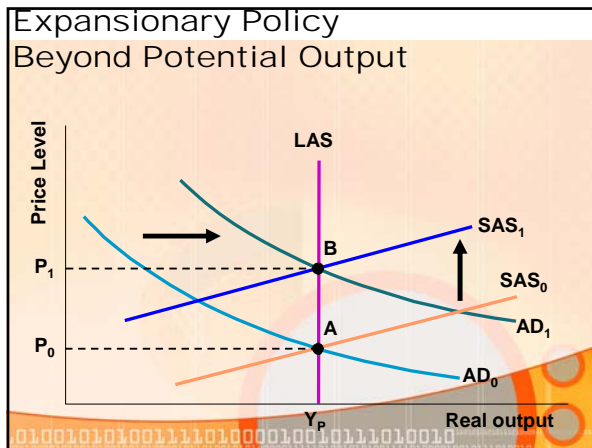
Effect of Monetary Policy on the Macro Policy Model

- *Expansionary monetary policy increases nominal income.*
- *Its effect on real income depends on how the price level responds.*

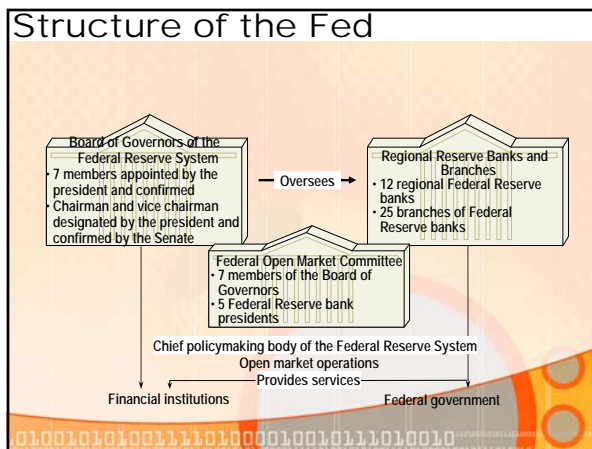
$$\% \Delta \text{Real Income} = \% \Delta \text{Nominal Income} - \% \Delta \text{Price Level}$$

Monetary Policy and the AS/AD Model

- *Monetary policy, controlled by the Fed, influences the economy through changes in the money supply and credit availability.*
- *Expansionary monetary policy shifts the AD curve to the right.*
- *Contractionary monetary policy shifts the AD curve to the left.*



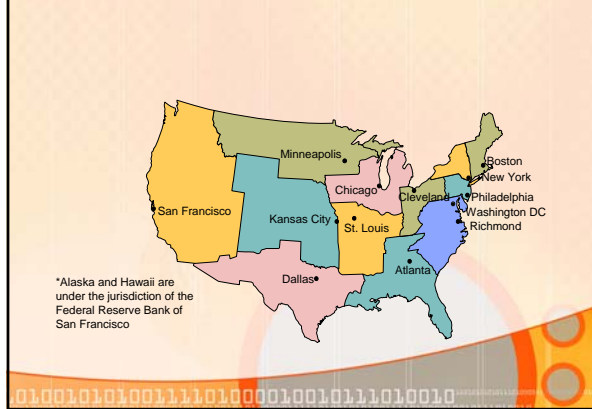
- ### Central Banks
- A central bank conducts monetary policy and acts as a financial adviser to the government.
 - *Central bank* – a type of bankers' bank.
 - The central bank's ability to create money gives it the power to control the money supply.



Structure of the Fed

- *The Fed is a semiautonomous organization composed of 12 regional banks.*
- *The Fed has much more independence than most government agencies.*
 - *The Fed does not rely on Congress for appropriations.*
 - *Its governors serve 14 year terms and cannot be reappointed.*

Federal Reserve Districts



Duties of the Fed

- *Conducts monetary policy*
- *Supervises and regulates financial institutions*
- *Lender of last resort to financial institutions*
- *Provides banking services to the U.S. government*
- *Issues coin and currency*
- *Provides financial services such as check clearing to commercial banks, savings and loan associations, savings banks, and credit unions.*

The Importance of Monetary Policy

- The *Federal Open Market Committee (FOMC)* makes actual monetary policy decisions.
- The FOMC is composed of:
 - The 7 members of the Board of Governors
 - The president of the New York Fed
 - A rotating group of 4 of the presidents of the other regional banks

The Conduct of Monetary Policy

- The Fed influences the amount of money in the economy by controlling the monetary base.
- *Monetary base* – vault cash, deposits of the Fed, and currency in circulation.
- *Reserves* – vault cash or deposits at the Fed
- Monetary policy affects the amount of reserves in the banking system.
- Reserves and interest rates are inversely related.
