The Federal Reserve, Monetary Policy, and Economic Indicators

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The Creation of the Fed

- The first two national banks, 1791-1836
- The need for a standard currency
- The Federal Reserve System is created in 1913 by President Woodrow Wilson
- The Fed opened for business in 1914 across 12 different cities
The Mission of the Fed

The Fed was created to:

- Influence the supply of money and credit through monetary policy
- Regulate and supervise financial institutions
- Provide financial services to local institutions
- Serve as a banking and fiscal agent for the U.S. government
Federal Reserve System Structure

Board of Governors
(7 members appointed by President, confirmed by Senate)

Federal Open Market Committee
(Board of Governors and five Reserve Bank Presidents)

Advisory Councils
• Consumer Advisory Council
• Federal Advisory Council
• Thrift Institutions Advisory Council

Federal Reserve Banks
(Twelve district Banks operate as arms of the central Bank)
Board of Governors

- Supervises and regulates the Reserve Banks
- Sets reserve requirements
- Approves changes in the discount rate
- Submits reports to Congress on state of economy
The Basics of Monetary Policy
Monetary policy decisions are forward-looking

“Based on historical experience, the FOMC knows that policy changes made today will affect economic growth and inflation with a lag of 6 or more months. So, the FOMC is largely concerned with what the economy might look like 6 months to 2 years ahead.”
Federal Open Market Committee

- FOMC meets eight times each year
- Reviews economic and financial conditions
- Determines appropriate stance of monetary policy
- Assesses the risk to its long-term goals of price stability and economic growth
- 12 voting members (seven Board of Governors, president of New York Fed, and four presidents from remaining 11 Federal Reserve Banks on a one-year rotating basis)
Monetary Policy Goals

Inflation
- Significant wage increases
- Significant price increases

Recession
- Significantly high unemployment
- Significantly shrinking business profits
Monetary Policy Tools

- Reserve requirements
- Discount rate
- Open market operations
Reserve Requirements

- Monies banks have to set aside with the Fed
- By raising or lowering, can affect the money supply

Discount Rate

- Interest Rate charged to banks to borrow money from Fed
- By raising or lowering, can affect banks’ supply of money
Open Market Operations

- Influences interest rates
- Buys or sells Treasury securities
  - Buys – Lowers Fed Funds rate, money supply up
  - Sells – Raises Fed Funds rate, money supply down
Effect of Policy on the Economy

Raise Fed Funds rate
- Economy slows
- Fewer loans
- Business revenues decrease
- More business failures
- Prices fall
- Greater unemployment

Lower Fed Funds rate
- Economy heats up
- More loans
- Business revenues increase
- More workers hired
- Prices increase
- Workers wages increase
Mechanics of the FOMC

- Discuss current economic conditions
- Decide on what action to take regarding rate
- Issue directive to trading desk
- Issue a statement
- Release minutes of the meeting
Key Economic Indicators
At mid-year, GDP was growing at about its long-term trend, but differed by sector.
Recent data suggest faster U.S. growth, and employment gains have been solid.
GDP growth was solid in 2013 and is projected to be even stronger through 2016.
Unemployment continues to fall and could reach long-term levels by 2015.
Inflation was low in 2013 and is expected to rise to around its long-term target by 2015.
Most FOMC participants project the first federal funds rate increase in 2015.
The Fed’s balance sheet is now set to grow slightly slower in 2014 than in 2013.
Unlike the nation, employment has risen above pre-recession levels in Oklahoma.
Rig counts have slipped somewhat but still remain relatively high.

**Oklahoma Active Drilling Rig Count**
Seasonally Adjusted

Number of rigs

- **Oil**
- **Natural Gas**

Source: Baker Hughes
And oil and gas production in the state has continued to increase.

Oklahoma Oil and Gas Production

Oil (left) and Natural gas (right)

Source: EIA
Drought conditions have improved since last year, helping some areas of the state.
Residential construction has continued to increase, despite higher mortgage rates.
But the government shutdown had some negative impacts in several states.
High energy, government, and low high-tech activity make Oklahoma different from U.S.

**Oklahoma and U.S. Employment Share by Industry, 2012**

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percent of Total Employment</th>
<th>Location Quotient</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural Resources &amp; Mining</td>
<td>3.7</td>
<td>1.6</td>
</tr>
<tr>
<td>Federal Government</td>
<td>3.1</td>
<td>2.2</td>
</tr>
<tr>
<td>State &amp; Local Government</td>
<td>19.3</td>
<td>14.4</td>
</tr>
<tr>
<td>Construction</td>
<td>4.5</td>
<td>4.4</td>
</tr>
<tr>
<td>Education &amp; Health</td>
<td>14.5</td>
<td>15.3</td>
</tr>
<tr>
<td>Trade, Transportation &amp; Utilities</td>
<td>18.7</td>
<td>19.9</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>8.7</td>
<td>9.4</td>
</tr>
<tr>
<td>Leisure &amp; Hospitality</td>
<td>9.5</td>
<td>10.8</td>
</tr>
<tr>
<td>Financial Activities</td>
<td>5.2</td>
<td>5.9</td>
</tr>
<tr>
<td>Professional and Business Services</td>
<td>11.4</td>
<td>14.1</td>
</tr>
<tr>
<td>Information</td>
<td>1.5</td>
<td>2.1</td>
</tr>
</tbody>
</table>

Note - Location quotient is the division of local employment share by national employment share.

Source: U.S. Bureau of Labor Statistics
Want to Know More?

- Board of Governors of the Federal Reserve System
  - www.federalreserve.gov
- Federal Reserve Bank of Kansas City
  - http://www.kansascityfed.org
- Federal Reserve Education
  - http://www.federalreserveeducation.org