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The Role of the Federal Reserve in the Economy

- I. Good morning. It's a pleasure to be with you today.
 - A. I'd like to try to answer some of the questions that I often hear people ask:
 - 1. What's the Fed's role in the economy?
 - 2. How does it function?
 - 3. What can it do for the economy?

- II. I'll begin by describing the Fed's role in a nutshell:
 - A. As the nation's central bank, the Fed basically does three things:
 - 1. It works to keep the banking, financial, and payments systems safe, sound, and stable.
 - 2. It also provides financial services to the government and the public.
 - 3. Finally--and very importantly--the Fed's conduct of monetary policy contributes to the long-run health of the economy by promoting maximum sustainable employment and stable prices.

 - B. Since its founding in 1913, it has evolved with some special characteristics:
 - 1. public and private
 - 2. national and regional
 - 3. subject to congressional oversight, but "independent" and insulated from day to day political pressures.

4. These characteristics create important checks and balances for conduct of policy and operations.
- C. Structure embodies public/private, national/regional, independent characteristics
1. BOG in Washington: 7 members with staggered 14-year terms; appointed by President with consent of Senate; Chairman preeminent.
 2. 12 Reserve Banks cover all 50 states
 - a Reserve Banks are each incorporated
 - b and have own boards of directors,
 - (1) made up of bankers, businesspeople, and the general public.
 3. SF Fed--Twelfth District
 - a Headquarters plus four branches cover largest geographic territory—nine westernmost states
 - b nearly one-fifth total US population and employment
 - c and almost one-sixth of total U.S. banking assets.
- D. Reserve banks provide banking services, bank supervision and regulation, and discount window.
1. Banking services
 - a check processing and collection
 - (1) SF handles over nine million checks per day
 - b electronic wire payments system (Fedwire)
 - (1) System handles \$2 trillion per day
 - (2) and San Francisco Fed accounts for about ten percent of that
 - c other electronic payments services (ACH)

- d banker for U.S. Treasury
 - (1) handles payments for Treasury through account at Fed
 - (2) sells Treasury securities and keeps track of ownership through book entry system
 - (3) provides fit coin and currency

2. Supervision and Regulation

- a State-chartered member banks
- b All bank holding companies
- c Foreign banks operating in U.S.
- d Large financial conglomerates that own banks, such as Charles Schwab and Countrywide Mortgage
- e Consumer protection regulations

3. Discount Window

- a provides temporary funds against collateral to depository institutions

III. Monetary policymaking also reflects national/regional, public/private, independent characteristics.

A. Conducted by FOMC

- 1. 12 members: 7 Governors plus 5 Reserve Bank presidents on a rotating basis.
- 2. All Reserve Bank presidents attend FOMC meetings and participate fully in discussions,
 - a providing independent perspective on national policy and regional information.

B. The tools the Fed uses to conduct policy are

- 1. open market operations--federal funds rate

2. discount rate.
3. With these tools, the Fed can affect credit conditions in the economy, which affect people's demand for goods and services, and ultimately economic performance.

IV. Now some of what I've described may seem kind of abstract to you.

A. But I think I can bring it to life by telling you a bit about how the Fed reacted to that disastrous day, September 11, 2001.

1. All of the functions I've just described came into play in the most dramatic way during those dark days.

B. Of course, the most profound effects were felt at the Federal Reserve Bank of New York.

1. It's just steps away from where the World Trade Center was,
2. and it's where the Fed actually handles the trading involved in implementing monetary policy.

C. But with the nation's markets and transportation systems facing massive disruptions,

1. *every* Reserve Bank had a role to play in ensuring the viability of our financial system and our economy.

2. And, as I go through the functions,

a I'll highlight some special efforts by the people in our Los Angeles Branch,

b who rose to meet some enormous challenges.

D. Within hours of the attacks, Fed Vice Chairman Ferguson issued this announcement:

1. "The Federal Reserve System is open and operating. The discount window is available to meet liquidity needs."
2. These few words said a lot.

- a They gave the public and the markets confidence that the Fed stood ready to do its part to keep the wheels of the economy from grinding to a halt.
- E. In our role as bank supervisors,
 - 1. we and other banking agencies encouraged banks to work with their customers to help meet their legitimate credit needs.
- F. In terms of the payments system, we kept things moving in vital services like electronic funds transfers, check-clearing, and currency processing.
 - 1. This took some extraordinary efforts.
 - 2. For example, in the checks area, the San Francisco Fed typically uses commercial flights to move checks around, both within the Twelfth District and among the other Districts.
 - a With commercial flights grounded, we had to come up with alternatives fast.
 - b So within the District—which, let me remind you, is huge, the biggest in the System—we hired couriers, rented trucks, and used our own vans to get things moving.
 - c Just to give you an idea of how enormous a task it was, at one point the Los Angeles Branch alone had to figure out how to get nine thousand pounds of checks from the branch building to a cargo plane in Burbank.
 - 3. Employees in the currency area also went to extraordinary lengths to keep cash moving.
 - a This was especially critical for our District Bank, because we have national responsibility for the Fed’s cash services.
 - b We quickly notified our customers and the press that we were open and ready to serve their needs, and we extended our hours of operation significantly.
- G. Now let me turn to the concerns about liquidity. This basically means we were concerned about blockages in the flow of money and credit. This could have become a huge problem.

1. And so the Fed met it with a huge response.
 - a We injected massive amount of liquidity into the financial system.
 - b And we used not only the tools I've already mentioned—open market operations and the Discount Window.
 - c We also used every available vehicle we could think of—
 - d —including float, overdrafts, swaps with foreign central banks.
 2. The day after the attacks, the total injection amounted to over one hundred billion dollars!
- H. Another critical step was to lower short-term interest rates.
1. We did so twice over the next three weeks—
 2. —by one hundred basis points in total.
- V. These and many other actions helped ensure that the financial markets could function efficiently as soon as possible.
- A. But that, of course, was not our ultimate goal.
1. Then—and now—it is only a *means* to our ultimate goal.
- B. In providing services and conducting policy, one concern is uppermost for the Federal Reserve.
1. And that is keeping this economy on track to produce
 - a sustainable employment
 - b and stable prices—
 - c —two cornerstones of American economic well-being and prosperity.

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