Two Fed Jobs

Bank safety and monetary policy in an ample reserve system

SS24.E.9a "Explain how the United States Federal Reserve System regulates the banking system and uses its tools of monetary policy through an ample reserve system to achieve its economic goals."

NAME _____ DATE _____

1 READ AND MARK

Read it twice

YOUR JOB Underline two bank safeguards or supervisory actions, circle two monetary-policy tools, and number the steps that connect a rate increase to a change in inflation.

One Bank, Two Fed Jobs

1. Imagine a regional bank facing a wave of withdrawals just as prices across the country rise rapidly. The Federal Reserve has two related, but different, jobs. As a supervisor, it examines certain banks and bank holding companies, checks whether they meet capital and liquidity requirements, and can require them to correct unsafe practices. Capital helps absorb losses; liquid assets help a bank meet withdrawals. These safeguards reduce the chance that trouble at one bank spreads. As a monetary policymaker, the Fed pursues maximum employment and stable prices across the economy, rather than setting each bank's lending decisions.

2. To influence borrowing across the economy, the Fed sets a target range for the federal funds rate, the rate banks charge one another for overnight reserve loans. In today's ample reserve system, banks collectively hold abundant balances at the Fed, so small changes in reserve supply do not strongly move that rate. The Fed instead mainly adjusts the interest rate it pays banks on reserve balances, called IORB. Raising IORB gives banks a stronger reason to keep reserves rather than lend them at lower rates. The Fed also offers eligible financial firms an overnight reverse repurchase facility, which helps put a floor under short-term rates.

3. If inflation stays high, the Fed can raise its target range and administered rates, including IORB. Higher short-term rates tend to lift other borrowing costs, slowing spending and easing pressure on prices, though jobs may weaken. If unemployment rises while inflation is contained, it can lower those rates to support borrowing and hiring. The Fed can also buy or sell Treasury securities to change the quantity of reserves, but in an ample reserve system it does not normally fine-tune the federal funds rate by making reserves scarce. Supervising a vulnerable bank and changing economy-wide interest rates address different problems.

2 ANSWER WITH EVIDENCE

Use the passage

1. How could a Fed examination and capital or liquidity requirements help prevent one bank's trouble from spreading?

2. Why does the Fed mainly adjust IORB, rather than make reserves scarce, to influence the federal funds rate in an ample reserve system?

3. Trace how a Fed rate increase could ease inflation, and identify one possible cost of that policy.

4. If unemployment rises while inflation is contained, how could lowering Fed rates help the Fed pursue one of its goals?

3 YOUR TURN

Your own words

A town's employers are cutting shifts while inflation is contained. A local bank reports losses and faces heavy withdrawals. In 70 to 95 words, propose one Fed supervisory response for the bank and one monetary-policy response for the economy. Explain how each works, distinguish their targets, and name one possible trade-off or limit.

ANSWER KEY

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GRADE 12 · SS24.E.9a

PART 1 · READ AND MARK

Underline two bank safeguards or supervisory actions, circle two monetary-policy tools, and number the steps that connect a rate increase to a change in inflation. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	How could a Fed examination and capital or liquidity requirements help prevent one bank's trouble from spreading?	**An examination can identify unsafe practices that the Fed requires the bank to correct. Capital absorbs losses, while liquid assets help the bank meet withdrawals.**
2	Why does the Fed mainly adjust IORB, rather than make reserves scarce, to influence the federal funds rate in an ample reserve system?	**Banks already hold abundant reserves, so small changes in their supply have little effect on the rate. Adjusting IORB changes the return banks can earn by holding reserves.**
3	Trace how a Fed rate increase could ease inflation, and identify one possible cost of that policy.	**Higher short-term rates can raise borrowing costs, slow spending, and ease pressure on prices. Jobs may weaken.**
4	If unemployment rises while inflation is contained, how could lowering Fed rates help the Fed pursue one of its goals?	**Lower rates can support borrowing and hiring, helping the Fed pursue maximum employment.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

The Fed could examine the bank's capital and liquid assets, then require it to correct weaknesses that threaten its ability to handle withdrawals. That response targets a specific institution and helps reduce the chance of wider banking trouble. With employment weakening and inflation contained, the Fed could lower its target range and IORB, encouraging lower borrowing costs, spending, and hiring. That response targets conditions across the economy, not just the bank. Lower rates could add inflation pressure if demand rebounds too quickly.

Accept other supported supervisory corrections and monetary-policy explanations that distinguish institution-specific oversight from economy-wide rate policy. Responses should not suggest that changing interest rates directly fixes the bank's losses.