The Rate Decision

How interest rates can steady a changing economy

9-12.GOV.29 "Describe how the Federal Reserve can use monetary policy to pursue price stability, full employment, and economic growth with the goal of stabilizing the economy."

NAME _____ DATE _____

1 READ AND MARK

Read it twice

YOUR JOB Underline each action the Fed can take, circle the economic goal it is meant to support, and number any possible cost or delay. Use your marks to trace how a policy choice can affect the economy.

A Bakery and the Bigger Economy

1. On a Saturday in a busy city, a bakery sells out before noon. Its owner raises prices because flour and wages cost more, while customers keep buying. Across town, firms advertise openings but struggle to hire. These signs may point to strong demand and rising inflation. The Federal Reserve, or Fed, does not set bakery prices or order firms to hire. Congress has given the Fed goals of stable prices and maximum sustainable employment. By influencing interest rates and the supply of money and credit, the Fed can help steady spending, support conditions for long-term growth, and limit sharp economic swings.

2. Suppose prices across the country keep climbing too quickly, not just at the bakery. The Fed can raise its target range for the federal funds rate, a short-term rate banks charge one another. To help put that target into effect, it adjusts rates it pays on bank reserves and can use market operations. Other interest rates often rise too, making loans for cars, equipment, and buildings more costly. Households and firms may borrow and spend less, easing pressure on prices. But slower spending may also reduce hiring. Higher rates do not instantly fix inflation, and their effects can take time to spread.

3. Now imagine sales fall nationwide and layoffs spread while inflation is easing. The Fed can lower its target rate range to encourage borrowing and spending. Cheaper credit may help a shop buy an oven, keep workers, and sell more bread. More jobs and production can support economic growth, but growth cannot be ordered into existence. If spending rises too fast, inflation could return. Policymakers therefore weigh both price stability and employment, study new data, and allow for delays before judging a rate change. When inflation and unemployment rise together, either choice has costs, so no single rate move guarantees a stable economy.

2 ANSWER WITH EVIDENCE

Use the passage

1. How could raising the Fed's target rate range help stabilize prices, and what might happen to hiring?

2. When sales fall and layoffs spread, how could lowering the target rate range support employment and economic growth?

3. Why could a rate cut that supports employment also threaten price stability?

4. When inflation and unemployment rise together, why can't the Fed count on one rate change to stabilize the economy?

3 YOUR TURN

Your own words

A drought raises food prices while employers cut shifts, but prices of other goods remain mostly steady. In 4 to 5 sentences, recommend whether the Fed should raise, lower, or hold its target rate range for now, and explain likely effects on prices, jobs, and growth, plus one risk or limit.

ANSWER KEY

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HIGH SCHOOL · 9-12.GOV.29

PART 1 · READ AND MARK

Underline each action the Fed can take, circle the economic goal it is meant to support, and number any possible cost or delay. Use your marks to trace how a policy choice can affect the economy. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	How could raising the Fed's target rate range help stabilize prices, and what might happen to hiring?	**Other interest rates often rise, making borrowing costlier. Reduced spending can ease pressure on prices, but it may also reduce hiring.**
2	When sales fall and layoffs spread, how could lowering the target rate range support employment and economic growth?	**Lower rates can encourage borrowing and spending. Businesses may buy equipment, keep workers, and produce more.**
3	Why could a rate cut that supports employment also threaten price stability?	**If the rate cut leads spending to rise too fast, inflation could return.**
4	When inflation and unemployment rise together, why can't the Fed count on one rate change to stabilize the economy?	**Raising rates may ease inflation but reduce hiring, while lowering rates may support jobs but increase inflation. Rate changes also take time to affect the economy.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

I would hold the target rate range for now while watching whether rising food prices spread to other goods. Holding avoids higher borrowing costs that might further weaken jobs and production. It also avoids encouraging extra spending that could push prices higher. A rate change cannot produce more crops after a drought. If inflation spreads or layoffs accelerate, the Fed may need to reconsider.

Accept a reasoned choice to raise, lower, or hold rates if the response connects that choice to prices, employment, and growth and identifies a plausible trade-off or limit. Students should not claim that monetary policy can end the drought or guarantee an outcome.