The Rate Decision

Trace how interest rates affect prices, jobs, and growth.

GE.7.5 "Analyze how the Federal Reserve uses monetary policy to promote price stability, full employment, and economic growth."

NAME _____ DATE _____

1 READ AND MARK

Read it twice

YOUR JOB Underline each possible Fed rate decision, circle its effects on prices, jobs, or growth, and put a star beside each trade-off.

A Price Tag and a Policy Choice

1. At a neighborhood grocery store, shoppers notice that the same basket of food costs more each month. When prices across the economy keep climbing too quickly, the dollars in a paycheck buy less. The Federal Reserve, or Fed, aims for price stability and maximum employment, while supporting conditions for lasting economic growth. Its long-run inflation goal is 2 percent, not zero: modest, predictable increases give households and businesses a steadier basis for planning. The Fed cannot set grocery prices or order employers to hire. Instead, it influences spending and borrowing across the economy through monetary policy.

2. Suppose rapid price increases reflect demand growing faster than businesses can supply goods and services. The Fed can raise its target range for the federal funds rate, a rate banks charge one another for overnight loans. Its policy tools help steer that rate, and other borrowing rates often rise too. More expensive loans can lead shoppers to postpone buying cars and firms to delay building new stores. Slower spending can ease pressure on prices, but those delays may also reduce hiring and slow growth. The effects take time, so the Fed must judge how much cooling is needed.

3. Now imagine sales weaken, employers cut hours, and inflation is low. The Fed may lower its target range to encourage borrowing and spending. Cheaper credit can help businesses fund equipment and keep or add workers, supporting employment and growth. Stronger demand may also push inflation upward toward the Fed's goal. Neither move guarantees a result: banks, borrowers, and businesses make their own decisions. If prices are rising quickly while jobs are disappearing, a rate increase could worsen job losses, while a rate cut could add to inflation. The Fed weighs both risks and adjusts policy as new information arrives.

2 ANSWER WITH EVIDENCE

Use the passage

1. When demand grows faster than businesses can supply goods and services, how could raising the Fed's target range help with price stability?

2. Why might the same rate increase make it harder to reach the goals of maximum employment and economic growth?

3. If sales weaken and employers cut hours while inflation is low, how could a rate cut affect jobs, growth, and inflation?

4. Why is the Fed's choice especially difficult when prices rise quickly while jobs disappear?

3 YOUR TURN

Your own words

A city has rising unemployment, inflation below the Fed's goal, and businesses putting off expansion. Write one paragraph proposing a Fed rate decision, tracing possible effects on borrowing, jobs, growth, and inflation, and explaining one uncertainty or risk.

The Rate Decision

PART 1 · READ AND MARK

Underline each possible Fed rate decision, circle its effects on prices, jobs, or growth, and put a star beside each trade-off. Accept any marking that follows this job and points at the right text.

PART 2 · ANSWERS

#	QUESTION	ANSWER
1	When demand grows faster than businesses can supply goods and services, how could raising the Fed's target range help with price stability?	**Other borrowing rates often rise, which can slow borrowing and spending. Slower demand can ease pressure on prices.**
2	Why might the same rate increase make it harder to reach the goals of maximum employment and economic growth?	**More expensive loans may cause firms to delay building new stores, reducing hiring and slowing growth.**
3	If sales weaken and employers cut hours while inflation is low, how could a rate cut affect jobs, growth, and inflation?	**Cheaper credit may increase borrowing and spending, helping businesses invest and keep or add workers. Stronger demand supports growth and may move inflation up toward the Fed's goal.**
4	Why is the Fed's choice especially difficult when prices rise quickly while jobs disappear?	**Raising rates could worsen job losses, but cutting rates could add to inflation. The Fed must weigh both risks.**

PART 3 · YOUR TURN (SAMPLE ANSWER)

The Fed could lower its target range for the federal funds rate. If other borrowing rates fall, businesses may find it cheaper to finance expansion. New projects could create jobs for residents and increase the city's economic activity. More spending might also move inflation closer to the Fed's goal. The outcome is uncertain because businesses may still avoid borrowing if they expect weak sales. If spending rises too quickly, inflation could eventually climb higher than the Fed wants.

Accept responses that trace a plausible chain from a Fed rate decision to borrowing, employment, growth, and inflation. Students should describe effects as possible, not guaranteed, and identify a relevant uncertainty or risk.