

FM225: Fixed Income Securities, Debt Markets and the Macro Economy

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Class 11: Monetary Policy

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Tools

- Open Market Operations
 - ▶ [Principal Tool]: Purchases and sales of U.S. Treasury and federal agency securities;
 - ▶ Determines the federal funds rate;
- Discount Window
 - ▶ Regional Federal Reserve Bank's lending facility for commercial banks and other depository institutions;
 - ▶ Primary/Secondary/Seasonal credit;
- Reserve Requirements
 - ▶ the amount of funds that a depository institution must hold in reserve against specified deposit liabilities;
 - ▶ Federal Reserve Banks pays interest on required reserve balances and excess balances

Federal Funds Rate

- Interest rate at which depository institutions lend balances at the Federal Reserve to other depository institutions overnight
- Fed sells securities \Rightarrow reserves draining $\Rightarrow r^{FF} \uparrow$
- Borrowing and lending are unsecured and take place overnight
- Target rate:
 - ▶ Set at FOMC meetings
 - ▶ Cut rate \Rightarrow easing credit; Increase rate \Rightarrow tightening credit;

Tools in Crisis

- Motivation: room for further cuts is limited when interest rates are close to 0.
- Credit Easing
 - ▶ Purchase a mix of (long-term) securities, affecting credit conditions for households and businesses;
- Quantitative Easing
 - ▶ Increase the supply of reserves;