

Policy Effects

Depository institutions are required to maintain reserves in certain proportions against various types of their deposits. Open market operations directly affect the level of reserves in the banking system. Federal Reserve purchases of securities add to reserves; sales withdraw reserves from the system. If reserves increase, depository institutions will generally acquire new loans and investments which will tend to exert downward pressure on interest rates.

The interest rate that is most directly affected by open market operations is the federal funds rate—the rate at which depository institutions lend reserves to one another, usually on an overnight basis. That rate is determined by supply and demand factors: if reserves are plentiful and few institutions need to borrow reserves, the federal funds rate is likely to be low; if reserves are scarce and many institutions are bidding for a limited quantity of available reserves, the rate is likely to be driven up.

Open market operations as directed by the FOMC are thus one of the tools used by the central bank to influence the total amount of money and credit available in the economy. The Federal Reserve attempts to provide enough reserves to encourage moderate growth in money and credit in keeping with the longer-run needs of an expanding economy.

Reports

By law, the Board of Governors is required to keep a complete record of the actions taken by the FOMC on all questions of policy and to include in its annual report to Congress the vote on and the reasons for each action. In order to provide this information on a timely basis, a "Record of Policy Actions" is prepared after each meeting and is released to the press and the public a few days after the next regularly scheduled FOMC meeting. Another report, "Minutes of Actions," lists policy and non-policy actions and is made available for public inspection at the same time the Record of Policy Actions for the corresponding meeting is released.

Twice a year, as required in the Full Employment and Balanced Growth ("Humphrey-Hawkins") Act of 1978, the Board submits a written report to Congress on the state of the economy and the course of monetary policy, and it may be called to consult with Congress on this report.

Board of Governors
of the Federal Reserve System
Washington, D.C. 20551

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2. A SERIES ON THE STRUCTURE OF THE FEDERAL RESERVE SYSTEM

The Federal Open Market Committee

The Federal Open Market Committee (FOMC) is the most important monetary policy-making body of the Federal Reserve System. It is responsible for the formulation of a policy designed to promote economic growth, full employment, stable prices, and a balance in international trade and payments. The FOMC makes key decisions regarding the conduct of open market operations—purchases and sales of U.S. Government and other securities—which affect the provision of reserves to depository institutions and, in turn, the cost and availability of money and credit in the U.S. economy. The FOMC also directs System operations in foreign currencies.

Membership of the Committee

The FOMC is composed of the seven members of the Board of Governors and five Reserve Bank Presidents. The President of the Federal Reserve Bank of New York serves on a continuous basis; the Presidents of the other Reserve Banks serve on a rotating basis for one-year terms beginning on March 1st of each year. Rotation is conducted so that each year one member is elected to the Committee by the Boards of Directors of each of the following groups of Reserve Banks: 1) Boston, Philadelphia, and Richmond; 2) Cleveland and Chicago; 3) Atlanta, St. Louis, and Dallas; and 4) Minneapolis, Kansas City, and San Francisco.

Organization

By statute, the Committee determines its own organization. At its first meeting on or after March 1st of each year, the Committee elects its Chairman and Vice Chairman and selects staff officers to serve the Committee for the coming year. Traditionally, the Chairman of the Board of Governors is elected as Chairman and the President of the Federal Reserve Bank of New York as Vice Chairman. Staff officers are selected from among the officers and employees of the Board of Governors and the Federal Reserve Banks. Officers include: a Secretary to maintain a record of actions taken by the Committee upon all questions of policy; economists to prepare and present to the Committee information regarding business and credit conditions and domestic and international economic and financial developments; General Counsel to furnish legal advice; and two Managers of the System Open Market Account—one for domestic and one for foreign operations—to execute and to report to the Committee on open market transactions.

Meetings

The law requires that meetings of the FOMC be held at least four times each year in Washington, D.C. upon the call of the Chairman of the Board of Governors or at the request of any three members of the Committee. Typically, meetings are held once every 5 to 8 weeks in the offices of the Board of Governors in Washington, according to a schedule tentatively agreed upon at the beginning of the year. If circumstances require consultation or consideration of an action between these regular meetings, members may be called on to participate in a special meeting or a telephone conference, or to vote on a recommended action by telegram or telephone. At each regular meeting, the Committee votes on the policy to be carried out during the interval between meetings; at least twice a year the Committee also votes on certain longer-run policy objectives.

Attendance at meetings is restricted because of the confidential nature of financial information discussed, and is limited to Committee members, nonmember Reserve Bank Presidents, staff officers, the Managers of the System account, and a small number of Board and Reserve Bank staff.

The Decision-Making Process

Prior to each regular meeting of the Committee, written reports from System staff on past and prospective economic and financial developments are sent to each Committee member and to nonmember Reserve Bank Presidents. Reports prepared by the Management of the System Open Market Account on operations in the domestic open market and in foreign currencies since the last regular meeting are also distributed. At the meeting itself, oral reports are given by staff officers on the current and prospective business situation, on conditions in financial markets and on international financial developments. For example, the Committee considers such factors as: inflation, labor market developments, employment and unemployment, production, retail sales, consumer spending, wages and income, residential construction, housing starts, exports and imports, business investment, inventories, business profits, interest rates, fiscal policy, and others. Oral reports on transactions in the System Open Market Account since the previous meeting are given by the Managers of the account.

Following these reports, the Committee members and other Reserve Bank Presidents discuss policy. Typically, each participant expresses his or her own views on the state of the economy and prospects for the future, and on the appropriate direction for monetary policy. Then each makes a more explicit recommendation for policy for the coming inter-meeting period (and for the longer run, if under consideration). Finally, the Committee develops a consensus regarding the appropriate course for policy which is incorporated in a directive to the Federal Reserve Bank of New York—the Bank selected by the Committee to execute transactions for the System Open Market Account. The directive issued by the FOMC is cast in relatively specific terms so as to provide concrete guidance to the Manager in the conduct of day-to-day open market operations. In its present form, the directive sets forth the Committee's objectives for longer-run growth in certain key monetary and credit aggregates. It also sets out short-term operating guides for rates of growth in the aggregates and an associated range of tolerable changes in money market conditions. Policy is conducted with emphasis on supplying reserves at a rate consistent with these objectives.