

16.2 Federal Reserve Functions

- **How does the Federal Reserve serve the federal government?**
- **How does the Federal Reserve serve banks?**
- **How does the Federal Reserve regulate the banking system?**
- **What role does the Federal Reserve play in regulating the nation's money supply?**

Serving Government

- **Federal Government's Banker**
 - The Fed maintains a checking account for the Treasury Department and processes payments such as social security checks and IRS refunds.
- **Government Securities Auctions**
 - The Fed serves as a financial agent for the Treasury Department and other government agencies. The Fed sells, transfers, and redeems government securities. Also, the Fed handles funds raised from selling T-bills, T-notes, and Treasury bonds.
- **Issuing Currency**
 - The district Federal Reserve Banks are responsible for issuing paper currency, while the Department of the Treasury issues coins.

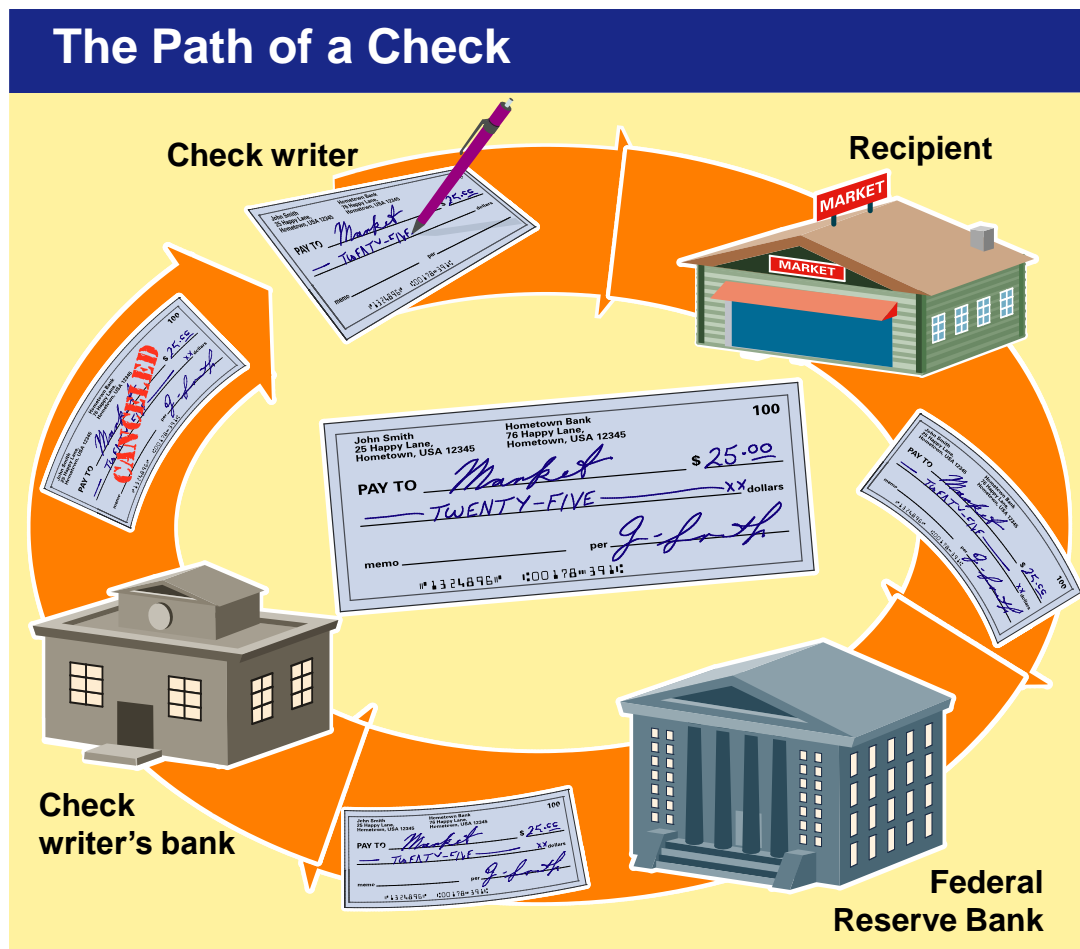
Serving Banks

- **Check Clearing**
 - **Check clearing** is the process by which banks record whose account gives up money, and whose account receives money when a customer writes a check.
- **Supervising Lending Practices**
 - To ensure stability in the banking system, the Fed monitors bank reserves throughout the system. The Fed also protects consumers by enforcing truth-in-lending laws.
- **Lender of Last Resort**
 - In case of economic emergency, commercial banks can borrow funds from the Federal Reserve. The interest rate at which banks can borrow money from the Fed is called the **discount rate**.



The Journey of a Check

- After you write a check, the recipient presents it at his or her bank.
- The check is then sent to a Federal Reserve Bank.
- The reserve bank collects the necessary funds from your bank and transfers them to the recipient's bank.
- Your processed check is returned to you by your bank.



Regulating the Banking System

The Fed generally coordinates all banking regulatory activities.

Reserves

- **Each financial institution that holds deposits for its customers must report daily to the Fed about its reserves and activities.**
- **The Fed uses these reserves to control how much money is in circulation at any one time.**

Bank Examinations

- **The Federal Reserve examines banks periodically to ensure that each institution is obeying laws and regulations.**
- **Examiners may also force banks to sell risky investments if their net worth, or total assets minus total liabilities, falls too low.**



Regulating the Money Supply

The Federal Reserve is best known for its role in regulating the money supply. The Fed monitors the levels of M1 and M2 and compares these measures of the money supply with the current demand for money.

Factors That Affect Demand for Money

1. Cash needed on hand (Cash makes transactions easier.)
2. Interest rates (Higher interest rates lead to a decrease in demand for cash.)
3. Price levels in the economy (As prices rise, so does the demand for cash.)
4. General level of income (As income rises, so does the demand for cash.)

Stabilizing the Economy

- The Fed monitors the supply of and the demand for money in an effort to keep inflation rates stable.



Section 2 Assessment

1. The Federal Reserve provides all of the following services to the government except
 - (a) issuing currency
 - (b) acting as the federal government's banker
 - (c) handling government securities auctions
 - (d) combining all banks into a single, central bank
2. The Fed provides banks with all of the following services except
 - (a) issuing interest free loans
 - (b) check clearing
 - (c) acting as a lender of last resort
 - (d) supervising lending practices

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