Monetary Policy: The Beige Book

Lesson Description

In this lesson, students are given the opportunity to play the role of a Federal Reserve Bank president in one of the aspects of an FOMC meeting: the policy go-round and federal funds target rate recommendation. Students will read and evaluate the anecdotal information contained in the Beige Book. The lesson begins with a discussion of the Federal Reserve's dual mandate of maximum employment and stable prices. Using a timeline, students will be introduced to legislation that directs Fed action. After a brief review of the Federal Reserve System's structure, students will see how the FOMC uses the anecdotal information contained in the Beige Book to inform policy decisions. After reading a Beige Book, students will conduct a policy go-round discussion and write a press release explaining the policy action agreed upon during the simulation.

Instructional Objectives

Students will:

- Identify the role of the FOMC in formulating monetary policy.
- Identify the legislative origins of the structure and goals of the FOMC.
- Analyze anecdotal information from the Beige Book to assess the balance of risks in the economy.
- Create an FOMC statement that contains a policy recommendation.

Time Required

One 50-minute class period

Materials Required

- SmartBoard
- Notebook file
- Copies of one section of a Beige Book report for each student
  Note: The Beige Book can be found on the Federal Reserve Board of Governors website at http://www.federalreserve.gov/fomc/beigebook/. The report can be downloaded as a PDF that contains an introduction and 12 sections corresponding to individual Federal Reserve Districts. Each student needs only one section, not the entire document.
- Copies of Handout 1 and 2 for each student

Warning

The first time you teach the lesson, save a master copy to your computer or a flash drive. If you do not, you will not be able to save notes from each class. Before each class, reload the master copy of the notebook file to be certain that all of the elements on each page are ready for use.

Procedure

1. Display Slide 1. Tell students that the topic of the lesson is the Federal Reserve and monetary policy.

2. Display Slide 2. Review the instructional objectives for the lesson.

3. Display Slide 3. Use the interactive definition on the slide and the information below to define monetary policy.
   - Touch the words "central bank" to display a definition of a central bank.
     - There are central banks throughout the world and they vary in structure and activities. The central bank of the United States is the Federal Reserve System.
   - Touch the words "availability and cost of money and credit" to display information about the way central banks affect interest rates by affecting the ability to make loans.
     - As the supply of loans rises, their prices (interest rates) fall. As the supply of loans falls, their prices (interest rates) rise.
   - Touch the words "national economic goals" to display information about the reason central banks conduct monetary policy.
     - National monetary goals are set, generally, by the governing bodies that the central bank serves. The central bank has the unique mandate and power to influence the nation's money and credit to promote the goals set by government. In the United States, the Federal Reserve System is charged with promoting stable prices and maximum employment.

4. Display Slide 4. Use the timeline and the information below to explain major legislative action that created the modern structure and mandates of the Federal Reserve System.
   - Touch the dot at 1913 to display information about the Federal Reserve Act.
     - The Federal Reserve Act created the Federal Reserve System as a dual system, containing regional Reserve Banks and the Board of Governors. In the act, the Federal Reserve is charged with providing for an elastic currency (monetary policy), banking supervision and rediscounting commercial paper (lender of last resort).
   - Touch the oval at 1933–42 to display information about the Banking Acts of 1933 and 1935 and the amendment in 1942.
     - The Banking Act of 1933 established the FOMC, made up of Reserve Bank presidents. The Banking Act of 1935 added governors to the membership and gave the committee the responsibility of conducting monetary policy. In a 1942 amendment to the 1935 act, the current voting structure of seven governors and five Reserve Bank presidents was established.
   - Touch the dot at 1951 to display information about the Treasury–Federal Reserve Accord of 1951.
     - During World War II, monetary policy decisions conducted by the Fed were subject to Treasury approval. After the 1951 Accord, the Federal Reserve System was allowed to conduct independent monetary policy.
   - Touch the dot at 1977–78 to display information about the 1977 Amendment to the Federal Reserve Act and the 1978 Humphrey–Hawkins Full Employment Act.
     - The amendment and the act created the national economic goals that guide the Fed's monetary policy actions. The goals are stable prices and maximum employment.

5. Display Slide 5. Use the graphics and the information below to review the three-part structure of the Federal Reserve System.
   - Point to the Board of Governors graphic.
     - The Board of Governors is the national part of the system. The seven governors are appointed by the president and confirmed by the U.S. Senate. The Board is located in Washington, D.C.
   - Point to the Federal Reserve Banks graphic.

  - There are 12 regional Reserve Banks located throughout the country. Each Bank has its own president, appointed by the Bank's Board of Directors and confirmed by the Board of Governors.
- Point to the Federal Open Market Committee graphic.
  - Monetary policy is set by the Federal Open Market Committee, or FOMC. The FOMC has 19 members: 12 Regional Reserve Bank presidents and seven governors from the Board of Governors. The FOMC uses input from the presidents and governors to carry out monetary policy.
  - At each of the FOMC meetings, the members consider both statistical research and anecdotal research when making policy decisions.
  - After each meeting, the FOMC sets a target for the federal funds rate—the interest rate banks charge one another for unsecured, overnight loans.

6. Display Slide 6. Use the information on the slide and contained below to describe the Beige Book.
- Distinguish between statistical and anecdotal information.
  - Statistical information includes a wide range of economic indicators relating to employment, prices and production.
  - Anecdotal information consists of personal observations of current economic conditions by Bank and branch directors, key business contacts, economists, market experts and other sources.
- All 12 Reserve Banks write a narrative that includes the information reported in their district. The 12 reports are compiled and summarized by a single Reserve Bank.
- The report came to be called the Beige Book in 1983 when it began to be released to the public with a cover printed on beige paper.
- The Beige Book is released approximately two weeks prior to the eight regularly scheduled FOMC meetings each year.
- Current and historical Beige Books can be found on the Board of Governors site at http://www.federalreserve.gov/fomc/beigebook/

7. Display Slide 7. Use the information on the slide and below to explain the two risks the FOMC considers when making a decision about monetary policy.
- Upside risks refer to conditions that threaten stable prices. In particular, events that could cause the overall price level to rise would be categorized as upside risks.
- Downside risks are conditions that could lower levels of employment (or create unemployment).
- In this lesson, thermometers will be used to indicate the level (or temperature) of the risks presented in the Beige Book.
- The FOMC makes policy recommendations based on the committee's assessment of the balance of these two categories of risks.

8. Display Slide 8. Use the information on the table and the information below to explain phrases that are used in the Beige Book.
- Point out the bolded words on the "Downside Risks" column. These are examples of the words used to imply risks to maximum employment in the economy.
- Point out the bolded words on the "Upside Risks" column. These are examples of the words used to imply risks to rising prices in the economy.

9. Display Slide 9. Tell students that they are going to act as the president of a Federal Reserve Bank and bring the information from their Bank's Beige Book to the discussion of the FOMC. Divide the class into 12 groups. Assign each group a Federal Reserve District.
- Touch any of the seals around the table to display a map of the district.

Distribute copies of Handout 1 and the chapter of the Beige Book corresponding to the group's assigned Federal Reserve District. Each group should fill out the table on Handout 1 using information on upside and downside risks found in the Beige Book.

10. Display Slide 10. After groups have finished reading and taking notes, conduct a go-round of the districts. Have one representative from each group present two or three pieces of information about the economic conditions in their district. Collect this information on the table on the slide.

11. Display Slide 11. Conduct a second go-round discussion. Each group should summarize their report by explaining their assessment of the balance of risks in the economy.
- Do economic conditions indicate that upside risks are more significant?
- Do economic conditions indicate that downside risks are more significant?
- Do economic conditions indicate that upside and downside risks are balanced?

Each group should come to the board and adjust the two thermometers near their district's chair to indicate the level of upside (thermometer on left) and downside (thermometer on right) risks in the economy. Based on this assessment, each group should make a policy recommendation. There are three policy options: up, down or no change.
- If upside risks are more significant than downside risks, the Reserve Bank president could recommend that the committee raise the target federal funds rate. Drag the up arrow into the box next to their thermometers.
- If downside risks are more significant than upside risks, the Reserve Bank president could recommend that the committee lower the target federal funds rate. Drag the down arrow into the box next to their thermometers.
- If the risks are balanced and low, the Reserve Bank president could recommend that the committee maintain the current target federal funds rate. Drag the "NC" box into the box next to their thermometers to indicate no change.
- If both risks are high, the Reserve Bank president must make a decision about which risk to address and recommend the appropriate change to the target federal funds rate.

12. Display Slide 12. Use the press release on the slide and the information below to examine the components of a press release issued following an FOMC meeting to communicate the policy action.
- The press release has three sections—the policy action and target fed funds rate, the summary of economic conditions and the balance of risks (upside and downside).
- As a class, read and discuss each section of the press release.
  - Use the SmartBoard highlighter to highlight the change to the target federal funds rate and the new target rate.
  - Use the SmartBoard highlighter to highlight the phrases that provide information about the overall economic conditions. Answers will vary, but could include:
    - "economic growth is moderating"
    - "cooling of the housing market"

    - “increases in interest rates and energy prices”
- Use the SmartBoard highlighter to highlight the phrases that explain the committee’s evaluation of the upside and downside risks in the economy. Answers will vary, but could include:
    - “Readings of core inflation have been elevated” (upside)
    - “inflation expectations remain contained” (upside)
    - “high levels of resource utilization” (upside)
    - “sustain inflation pressures” (upside)
    - “moderation in growth of aggregate demand” (downside)

13. As an assessment, distribute Handout 2. Have students work in the Reserve Bank groups to construct an FOMC statement based on the information from the go-round discussion during the simulation. Remind students that the statement must include the three components of a real FOMC statement.

- Policy action: target for the federal funds rate
- Summary of economic conditions
- Assessment of the balance of risks between price stability and sustainable economic growth

Handout 1

Name______________________________

Federal Reserve District____

Threats to Maximum Employment (Downside Risks)	Threats to Stable Prices (Upside Risks)

Balance of Risk:

Reasons:

Policy Recommendation:

Handout 2

Name________________________________

PRESS RELEASE

Policy Action:____

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Economic Conditions:____

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Balance of Risks:____

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