

MODULE

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● 33 Defining and Measuring Money

● 34 Banking and Money Creation

● **35 The Federal Reserve System**



The Federal Reserve System

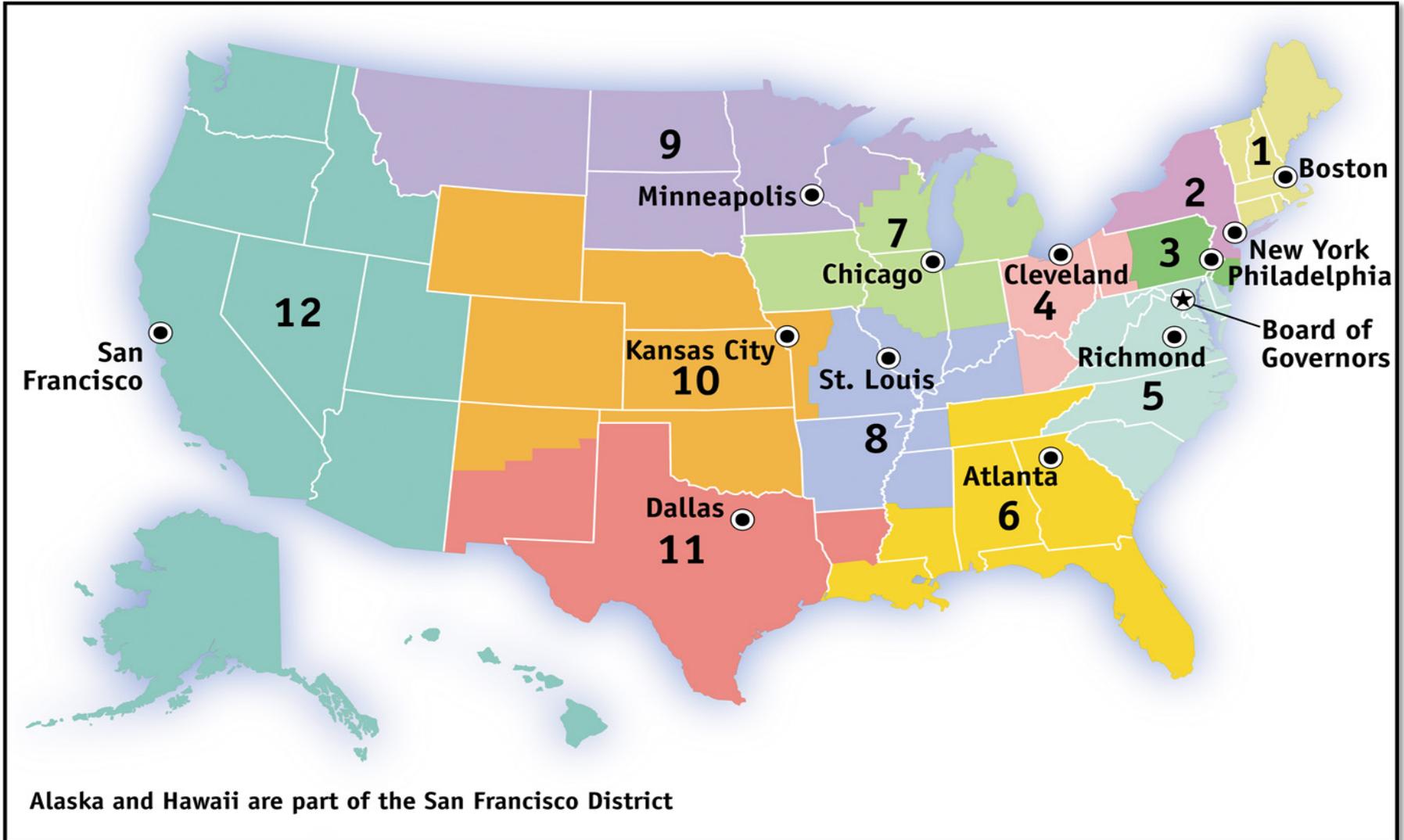
- The **Federal Reserve** (i.e., the Fed) is the U.S. central bank—an institution that oversees and regulates the banking system, and controls the monetary base.
- The Federal Reserve Bank was created in 1913 in response to frequent banking crises at the turn of the century.

The Structure of the Fed

- The Federal Reserve system consists of the Board of Governors in Washington, D.C., plus regional Federal Reserve Banks.
- The Federal Reserve Banks serve each of the 12 Federal Reserve districts.



The Structure of the Fed



Effectiveness of the Federal Reserve System

- The Great Depression sparked widespread bank runs in the early 1930s, which worsened and lengthened the depth of the Depression.
- Federal deposit insurance was created, and the government recapitalized banks by lending to them and by buying shares of banks.
- By 1933, banks had been separated into two categories: **commercial** (covered by deposit insurance) and **investment** (not covered).
- Public acceptance of deposit insurance finally stopped the bank runs of the Great Depression.

Savings and Loan Crisis of the 1980s

- The **savings and loan (thrift)** crisis of the 1980s arose because insufficiently regulated S&Ls engaged in overly risky speculation and incurred huge losses.
- Depositors in failed S&Ls were compensated with taxpayer funds because they were covered by deposit insurance.
- The crisis caused steep losses in the financial and real estate sectors, resulting in a recession in the early 1990s.

The Financial Crisis of 2008

- **Subprime lending** during the U.S. housing bubble of the mid-2000s spread through the financial system via **securitization**.
- When the bubble burst, massive losses by banks and nonbank financial institutions led to widespread collapse in the financial system.
- To prevent another Great Depression, the Fed and the U.S. Treasury expanded lending to bank and nonbank institutions.