SECTION 10  MONEY, BANKING, AND THE FEDERAL RESERVE SYSTEM

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

Alaska and Hawaii are part of the San Francisco District
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.
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.