Visual 2: Key Facts about the Federal Reserve

The Federal Reserve System is the Central Bank of the United States. It has two objectives for the U.S. economy.

1. Price Stability. A low and stable rate of inflation maintained over an extended period of time. The Fed's goal for the inflation rate is 2 percent over time.
2. Maximum Employment. The Fed uses its monetary policy tools to help the economy reach its potential. There is no numerical goal for this, but economists sometimes talk about "full employment."

The Fed uses its monetary policy tools to influence interest rates to reach these objectives. By influencing interest rates, the Fed influences the spending decisions of consumers and businesses.

When the economy is in recession, the unemployment rate will often increase to a level that is not consistent with the Fed's "maximum employment" mandate. In that case, the Federal Reserve could use its monetary policy tools to decrease interest rates.

- Lower interest rates decrease the cost of borrowing money, which encourages consumers to spend on goods and services and businesses to invest in new equipment and technology.
- Businesses respond to the increase in spending by increasing their production of goods and services.
- With increased production, businesses will likely hire additional employees.
- As employment increases, and people earn more money, they will likely increase their spending on goods and services.
- As the spending works its way through the economy, the unemployment rate will likely decrease back towards its maximum employment level.
- As the economy moves back to a healthy state, the Fed will adjust its monetary policy tools to move interest rates back to a normal level.

At other times inflation might rise above the Fed's two percent inflation goal. When that occurs, the Fed can increase interest rates.

- As interest rates rise, consumers and firms will decide that some purchases and investments are no longer feasible.
- As firms and consumers reduce their spending, inflationary pressures diminish.
- As the change in spending works its way through the economy, the inflation rate will likely move back to the Fed’s 2 percent goal and the Fed will adjust its monetary policy tools to move interest rates back to a normal level.