Money Supply Endogeneity

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Reserve Quantity Setting

Reserve Price Setting

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"Reserve Price Setting" or

Money Supply Endogeneity:
The real issue is whether banks are "community-oriented," as indicated in the previous section. The term "community-oriented" is used to describe the extent to which banks engage in activities that benefit the local community. This concept is often associated with banks that have a strong sense of responsibility to the community they serve, and that prioritize the needs of their local customers. However, there is no clear consensus on what constitutes a "community-oriented" bank, and different banks may define this concept in different ways.

In the United States, community-oriented banks are typically distinguished from traditional banks by their commitment to the local community. These banks may offer a wider range of financial products and services to local businesses, and they may also engage in community development activities, such as providing funding for local projects or participating in community events. In addition, community-oriented banks are often more responsive to the needs of their local customers, and they may be more willing to take risks on new or niche markets.

Despite these differences, there is no consensus on whether community-oriented banks provide better returns for their customers or for the local community. Some argue that community-oriented banks are better able to meet the needs of their local customers, while others argue that traditional banks are better able to provide broad-based financial services.

In conclusion, the concept of community-oriented banking is an important one that deserves further study. While there is no clear consensus on what constitutes a "community-oriented" bank, there is general agreement that these banks play an important role in the local community. Future research should focus on understanding the benefits and drawbacks of community-oriented banking, and on identifying strategies for promoting the development of community-oriented banks.
search for reserves. The essence of the "reserve price setting" position is that solvent individual banks can always obtain additional reserves at the market rate. The Federal Reserve regards lower than market rate (subsidized) borrowing at the discount window "as a privilege and not a right." Since the Fed discount officer is continually observed to turn down requests for funds from individual banks, it superficially appears that the Fed is able quantitatively to control the total amount of reserves it supplies. But while individual banks are unable to borrow additional funds at the discount window at the subsidized rate, they are always able to borrow unlimited funds at the market rate, in the federal funds market, the Eurodollar market, by issuing CDs, by selling securities, repos, etc. From the system's point of view, only borrowing from the discount window adds to the total supply of reserves. But from the individual bank's point of view, additional funds from any source whatsoever are exactly equivalent to funds directly borrowed from the central bank in meeting reserve requirements (Goodhart, 1975 [1989], pp. 129–155).

2. Substitutability

Pollin's tests of the implied degree of substitutability between borrowed and nonborrowed reserves in the two views are similarly misspecified. Both borrowed and nonborrowed reserves are obviously imperfect substitutes with regard to their ability to meet reserve requirements. Since total required reserves are always predetermined by the previously existing quantity of reservable deposits, even with contemporaneous reserve accounting (Moore, 1985b), and total nonborrowed reserves are determined by central bank nondefensive open market operations, the monetary authorities have no choice but to provide the residual quantity (borrowed reserves), if banks in the aggregate are to meet their reserve requirements. The fact that borrowed reserves are currently only 4 percent of total reserves merely reflects the fact that the Fed's "frozen costs," under the current degree of borrowing surveillance at the discount window, rise very sharply with increased discount window applications. Subsidized discount window borrowing is primarily for emergencies.

Profit-maximizing banks by definition attempt through arbitrage to equate their marginal cost of funds across all sources, adjusting for any differences in risk, maturity, and transactions costs. One reason why Pollin's substitutability test is misspecified is that different banks have different degrees of reluctance to borrow at the discount window. It is not merely that "frozen costs" increase rapidly with the amount of an individual bank's discount window borrowing (although they do). But "frozen costs" (substitutability) also differ widely among different individual banks, for any given level (quantity) of borrowing. Nevertheless, as the differential of the federal funds rate over the discount rate increases, additional banks are incrementally induced to borrow for the first time, and borrowed reserves will rise.

If total reserves were constant, changes in nonborrowed reserves (NBOR) would be perfectly negatively correlated with changes in borrowed reserves (BOR), even when deflated and transformed into first differences of logs, since the total of ΔNBOR + ΔBOR would then have to sum to zero. As a result, whenever the change in total reserves is zero (or very small), changes in NBOR will be negatively correlated with changes in BOR. This is the relationship Pollin's Table 4 reveals. However, when total reserves change (e.g., increase), the extent to which the Fed chooses to increase NBOR by open market purchases, and the extent to which it forces the banks into the discount window so as to increase BOR, are both at the Fed's discretion. In periods when the Fed wishes to restrain money supply growth, it will raise NBOR as required reserves increase, but by less than the full amount, so that BOR also increases. This would imply that in such periods Pollin's β coefficient would be positive. This may explain why the estimated negative value of β is smaller in all regressions in Table 4 for the second subperiod (1967–88) than for the first subperiod (1953–66). The years 1967–88 include the period 1979–82 when the Fed was vigorously attempting to restrict money growth, and as a result raising interest rates more sharply by providing only limited increases in NBOR, and forcing banks to a greater extent into the discount window whenever credit demand and monetary growth rose above the Fed's targets. It also explains why the results are less satisfactory with quarterly than with monthly data, since changes in total reserves are greater.

The estimated sign of β thus again sheds no light whatever on the extent to which borrowed and nonborrowed reserves are perfect substitutes. The fact that the $R^2$ values are low is simply due to the weakness of the test. Depending on Fed policy, positive, negative, or even zero correlation between NBOR and BOR is perfectly consistent with NBOR and BOR being perfect substitutes. It is thus quite invalid for Pollin to attempt to infer the degree of substitutability between NBOR and BOR from the estimated values of his β coefficients.
3. Casually

The Federal Reserve is the central bank of the United States. It conducts monetary policy and regulates the money supply. The Federal Reserve is independent of the government but is responsible to Congress. It is governed by the Federal Reserve Board, which is composed of seven members appointed by the President and confirmed by the Senate. The Federal Reserve System consists of 12 regional Federal Reserve Banks, each of which is a separate corporation. The Federal Reserve Banks are owned by the member banks and are governed by their own boards of directors. The System's operations are financed through the sale of securities to the public and by earnings from its lending activities. The Federal Reserve's primary tools for conducting monetary policy are open market operations, which involve buying and selling government securities in the open market, and setting discount rates, which is the interest rate charged to banks for borrowing from the Federal Reserve. The Federal Reserve's dual mandate is to promote maximum employment and stable prices.
REFERENCES

1987.

1975.

1979.

In explaining the Fed’s current highly accommodatory policy, it is necessary to consider how the money market operates and how it affects the economy. The Federal Reserve System, through its control of the federal funds rate, influences the behavior of banks and other financial institutions, thereby affecting the availability of credit and the cost of funds. This, in turn, affects the overall level of economic activity and inflation.

Overall, the Fed’s current policy is consistent with its stated objectives of price stability and maximum sustainable economic growth. The Fed’s actions are guided by its dual mandate of price stability and maximum employment, as outlined in the Federal Reserve Act of 1913.