Federal Reserve Activity

For this activity the students will be separated into group of four. For the average size class of 25, 6 scenarios will be needed (can be adjusted as necessary for class size). After the students are in groups, we will distribute different economic scenarios. The seven different scenarios (2 examples included) were given to the FOMC on different dates. Each of these scenarios will be explained briefly on a worksheet to be handed out at the beginning of the activity.

Then have the members of the group act as if they are the FOMC and create their own Federal Open Market Committee statement that would be released to the press. They will answer the following questions in their analysis:

a. Did they decide to raise, lower or keep the same Federal Funds Rate  
b. If they decide to raise or lower the FFR, how many points are they going to increase/decrease the rate?
 c. What were the three main indicators behind their decision?
 d. What impact do you expect this decision to have on the open market economy? How does this impact inflation expectations in the short and long term?

To get the entire class involved, we will use a random number generator for each of the questions. Each group member will then answer a question or help to answer a question from the worksheet, ensuring that all members actively participate. Each group will present their decision to the class, discussing their policy decisions and expectations. Inform each of the groups whether their actions matched those taken by the FOMC on that date. Any group that matches exactly the actions taken by the FOMC receives a prize. We will also discuss why they made the choices they did separate from the FOMC, and how those changes would impact the economy.

(see attached scenarios and worksheet.)
Scenario 1: November 15, 1994

- *The current Federal Funds rate is 4 ¼ percent*
- Consumer spending was robust, business fixed investment continued on a strong upward trend, and housing activity had been well sustained despite the increase in mortgage interest rates over the past year
- Business inventory investment had been brisk since the spring, apparently in response to the strong growth in final sales
- Sizable gains had been recorded in industrial production and employment.
- Tentative signs of wage acceleration associated with the further tightening of labor markets.
- Prices of many materials continued to move up rapidly
- Employment, as measured by the household survey, increased by more than the labor force in October, and the civilian unemployment rate edged down to 5.8 percent.
- Consumer confidence remained at a high level, and retail sales continued to rise rapidly
- Persisting upward pressures on prices at earlier stages of production
- Robust business expansion in many parts of the country and growing difficulties in hiring and retaining some types of labor. Ongoing cutbacks in some industries, such as defense, were tending to hold down overall economic activity in a few regions, but all parts of the country appeared to be experiencing at least modest economic growth

Scenario 2: July 6, 1995

- *The current Federal Funds Rate is 6 percent*
- Consumer spending apparently remained sluggish, and business spending on plant and equipment rose less rapidly than in other recent quarters.
- With final sales flagging, firms sought to hold down production and employment in order to keep inventories under control.
- Broad indexes of consumer and producer prices had increased faster on balance thus far this year, but signs of some moderation in inflation were evident in recent price data. Growth of labor compensation costs remained subdued.
- The civilian unemployment rate edged lower to 5.7 percent
- Manufacturing output fell in May for a fourth consecutive month, reflecting another cutback in the production of motor vehicles. Output of non-auto manufactured goods was unchanged, with increases in the production of nondurable consumer goods and non-auto business equipment offsetting declines in output elsewhere.
- The retail sales reports, in combination with data on consumer prices and unit motor-vehicle sales, suggested that inflation-adjusted spending for consumer goods had changed little since the fourth quarter of last year.
- Incoming data suggested that price inflation might be slowing a little after having picked up early in the year. Consumer prices rose a bit less in May; energy prices recorded another sizable increase, but food prices changed little and prices of other items advanced more slowly.
Federal Open Market Committee (FOMC) Press Release

(1) The Federal Open Market Committee decided today to (raise / lower /maintain ) its target for the Federal Funds rate (0 / 25 / 50 / 75 ) basis points to __________ percent.

(2) These are the three economic indicators that we considered when making this decision, and why we as the FOMC believed that they justify our decision whether or not to adjust the Federal Funds Rate:

   a. Indicator one:

   b. Indicator two:

   c. Indicator three:

(3) Today’s policy action will have the following effects on the open market economy:

   a. Inflationary expectations:

   b. Economic growth: