Cheat sheet to the Fed

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The Federal Reserve is the United States central bank, and it is technically independent of the branches of the government, yet subject to political appointments and potential legislative constraints.

Taking advantage of the powerful impact time can have on your savings

The stated goals of the Fed are to maintain low unemployment and to keep prices stable (keep inflation low).

The Fed operates primarily by controlling the supply of money to the banks (monetary policy). Banks hold a great amount of bonds in their reserves, and the Fed modifies the amount to influence the levels of cash available for lending.

When the Fed wants to stimulate the economy (often when there is a recession and when unemployment is high or moving higher), it buys bonds from the bank with cash. This cash is then available (presumably) to lend out at lower interest rates (more supply, lower prices for the cash) in order to stimulate business activity.

Next: Inflation moves higher, what does that mean?

Conversely, if inflation is moving higher and the economy seems overheated, the Fed can make the banks buy bonds to soak up cash, thereby decreasing lending.

When to know if you need to refinance a mortgage

Typically in the past, the bonds that were used were high quality government bonds. However, in the years following the great recession of 2008-2009, the types of bonds purchased by the Fed included those of much lower quality in order to get cash out into the economy (this purchase of "less than quality" bonds was termed quantitative easing).

The Fed signals its intent in order to decrease volatility in the bond and stock markets. They do this with both speeches (witness Fed Chair Janet Yellen's removal of the word patience in a March 2015 speech, suggesting that interest rate rises were being contemplated), and with

changes in what is called the Fed Discount Rate.

The Discount Rate is an interest rate that the Fed charges to banks for borrowing on short term needs. It is not really the amount that is lent, but the direction of interest rates charged that is the signal. So, if the Fed wants to signal that it would like rates to increase, it will usually increase the Discount Rate.

Next: Not a perfect indicator

This is not a perfect indicator, and you will usually see reference to the Federal Funds rate instead. The Federal Funds rate is the interest rate that banks charge to each other for loans, and tends to be a better measure of all the Fed's various efforts.

If you see the Federal Funds rate increasing steadily, it suggests that the Fed is coordinating efforts to slow the economy.

Should you own real estate as an investment?

So, if you see the Discount rate and the Federal Funds rate moving in the same direction, it is reasonable to believe that more movement in that direction is likely. However, there are many times in which the two indicators are not moving together, and the inferences are not as clear.