
Lesson by

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Lesson Description

This simulation activity features an examination of the *Beige Book*, a summary of economic conditions used to assist Federal Open Market Committee members in the formulation of monetary policy. Students are divided into at least five to as many as 12 of the Federal Reserve Districts where they utilize specific categories to summarize current economic conditions. Once the information is analyzed, students then determine, as a class, the outlook for economic growth and inflation.

Age Level

High school

Content Standards

NCEE National Standards in Economics

- √ Standard 15: Growth
- √ Standard 16: Role of Government
- √ Standard 18: Macroeconomy: Income/Employment Prices
- √ Standard 20: Monetary and Fiscal Policy

NCSS Curriculum Standards for Social Studies

- √ II: Time, Continuity and Change
- √ V: Individual, Groups and Institutions
- √ VI: Power, Authority and Governance
- √ VII: Production, Distribution and Consumption

Concepts

Beige Book
Credit Tightening

Economic Growth
Federal Open Market Committee (FOMC)
Inflation
Monetary Policy
Structure of the Federal Reserve System
Unemployment

Teachers Note: This lesson is designed to reinforce classroom instruction. You may wish to review the economic concepts with the students prior to conducting the lesson. In preparation for this class activity, you may consider having the students identify each term, and state its significance or relevance to monetary policy. Please refer to the opening discussion and closure activity for term identification. The Fed Today lesson plans also provide useful definitions and explanations for most of the terms mentioned above.

<http://www.philadelphiafed.org/education/appendix1.pdf> - page=2

In addition, the New York Federal Reserve provides descriptions and current charts of the 12 key economic indicators. <http://www.newyorkfed.org/education/bythe.html>.

Related Subject Areas

This lesson is intended to supplement the curriculums for high school business, economics, government or U.S. history courses.

Objectives

Students will be able to:

- ∨ demonstrate how the FOMC analyzes current economic information and anecdotal evidence to determine the best approach to monetary policy
- ∨ discuss and explain the formulation and importance of monetary policy
- ∨ explain the effects of inflation and unemployment on the economy
- ∨ synthesize and analyze current economic conditions to evaluate the health of the U.S. economy.

Time Required

The time required for this lesson depends on the class size and number of Districts participating in the simulation. For five district presentations, recommended time allotment is 90 minutes. For 12 district presentations, recommended time allotment is 2-90 minute classes, or 2 blocks.

Materials

- ✓ 1 poster board or self-adhesive wall pad sheet per group. (20" x 26" minimum)
- ✓ 2 colored Sharpie markers per group.
- ✓ If using poster board, masking tape is needed to hang each group's summary.
- ✓ Student copies of the *Beige Book* summary of each District.
(For teachers interested in limiting copying, you may wish to either provide just a couple of copies per group or conduct the activity in a computer lab.)
- ✓ Lesson plans to accompany *The Fed Today*, available online, at:
<http://www.philadelphiafed.org/education/ftlesson.html>.

Teachers Note: It is not necessary to copy the general summary at the beginning of the Beige Book report for each student. (The summary is useful for teacher instruction.) Instead, only copy the Districts that your class will be using for the simulation; enough for each student in the group.

For example, if you had a total of 25 students and divided the students into five members per group, you only need to provide five copies of each of the Districts chosen for the simulation.

Please refer to the link provided to obtain a copy of the January 2008 Beige Book:
<http://www.federalreserve.gov/fomc/beigebook/2008/20080116/FullReport.htm>.

Additional Note: You may alter this activity to fit any Beige Book (not just the January 2008 edition). Also, you may wish to alter the closure questions for the activity, depending on current economic conditions.

Procedures

Optional Bell Ringer Activity

1. To spark student interest, instructors may want to show a clip of the *PBS News Report* on the performance of the U.S. economy in late 2007, and the economic outlook for 2008. Please note that you may show just a few minutes of the clip to present an effective overview of the U.S. economy.
(http://www.pbs.org/newshour/bb/business/july-dec07/economy_12-26.html)
2. Additional Federal Reserve publications that correspond well with the lesson and provide an effective overview of the Federal Reserve System in a video and DVD format are: *The Fed Today* and *In Plain English*. For more information, please click on the following links: <http://www.frbsf.org/education/curriculum/fedtoday.html> and http://stlouisfed.org/publications/pleng/monetary_policy.htm.

Activity

1. Opening Discussion: Before beginning this activity, teachers may want to reinforce students' basic understanding of the key macro-economic concepts. You might begin by offering up these scenarios and/or posing these questions to assist the transition and flow of the lesson.
 - ∨ If you were a mechanic, how would you determine if a car would pass the state inspection?
 - ∨ If you were a doctor, how would you determine if a patient was healthy?
 - ∨ If you owned a business, how would you ascertain whether or not you were making a profit?

In each of these instances, you need to gather vital information to determine the health of your car, your patient and your business. In addition, trained experts and/or personnel are required to analyze the data.

- ∨ Have you ever wondered how the U.S. government determines the health of the U.S. economy?
- ∨ Have you ever considered how the Federal Reserve Board of Governors, the FOMC and the Federal Reserve Banks gather together information about the health of the U.S. economy?

In an effort to judge the overall health of the nation's economy, the government has many federal agencies that gather information about the status of the nation's economy like the Bureau of Labor Statistics, the Bureau of Economic Analysis, the Treasury Department and the Commerce Department, just to name a few. The Federal Reserve Board of Governors is a government regulatory board that also collects information about the nation's economy. The Federal Reserve System, the nation's central bank, collects economic data and anecdotal information to assess the overall health of the nation's economy and to determine monetary policy.

2. Based on student research and/or prior knowledge, pose the following questions:
 - ∨ What is monetary policy? (*"The primary objective of monetary policy is to influence the amount of money and credit in the economy in order to promote sustainable economic growth, full employment and stable prices."*¹ *The FOMC attempts to accomplish this goal by setting a target for the fed funds rate, the interest rate that banks charge one another for short term loans. **Changes in the fed funds rate typically affect other short-term lending rates.** The Federal Reserve has three monetary policy tools: open market operations, the discount rate and reserve requirements to assist in the attainment of economic growth and price stability. Open market operations—the buying and selling of government securities—provide the FOMC the most flexible means of achieving its goals. Conducted by the New York Fed's Domestic Trading Desk on behalf of the Federal Reserve System, Open Market Operations adjust the level of reserve balances for banks, and thus, can influence short term interest rates (fed funds*

rate) and by extension, other interest rates. The discount window is where commercial banks, thrift institutions and U.S. branches and agencies of foreign banks can borrow from the Federal Reserve. The FOMC may change—depending on current economic conditions—the terms and conditions for borrowing from the Federal Reserve (<http://www.newyorkfed.org/aboutthefed/fedpoint/fed18.html>). Reserve requirements mandate the minimum percentage of reserves held by banks. While reserve requirements could be modified to achieve monetary policy goals, in practice, they are not. (The reserve requirement has not changed significantly since the early 1980s.) For a more detailed explanation of reserve requirements and the discount rate, please refer to The Fed Today lesson plans (p. 38) or the New York Fed's Web site: <http://www.newyorkfed.org/aboutthefed/fedpoint/fed18.html>.

- v What is the FOMC? (The FOMC is a quasi-governmental body that is comprised of all seven members of the Board of Governors, and the president of each Federal Reserve Bank. The voting members of the FOMC consist of the seven members of the Board of Governors, the president of the New York Federal Reserve Bank, and the presidents of four other Reserve Banks who serve on a one-year rotating basis.)²
- v How is the Federal Reserve System structured? (The Federal Reserve is a “decentralized central bank” with both private and public elements operating independently within the government. The Board of Governors of the Federal Reserve is a government agency. The 12 Federal Reserve Banks are not government agencies; they represent the private component of the Fed.)³
- v What types of information does the FOMC use to determine current economic conditions? What is the Beige Book? (The FOMC considers a variety of economic information to implement monetary policy. Examples include real GDP, the consumer price index, retail sales, industrial production and capacity utilization, housing starts and the unemployment rate, just to name a few. Each Federal Reserve Bank also uses its own team of Research economists, Bank and branch directors, key business contacts, market experts, etc. to collect anecdotal information about the health of the economy in each of the individual Districts. This information is generally collected by survey. Much of this information is then summarized in the Beige Book.)
- v What is inflation? (Inflation is defined as a rise in the general level of prices over a sustained period of time. Inflation can be caused by too many dollars chasing too few goods. Inflation can be caused by increased costs of making and selling goods. Inflation is often measured by the Consumer Price Index (CPI).)⁴
- v What is economic growth? (“A measure of annual change in the amount of goods and services produced (output), usually defined as the annual percentage change in real Gross Domestic Product (GDP).”)⁵

- v Why is it important to have economic information or anecdotal evidence on economic growth, and inflation? (*The FOMC, according to its 1977 mandate, is charged with maintaining price stability and promoting sustainable economic growth. To fulfill its mandate, the Fed keeps track of economic conditions and anecdotal information to determine the course of monetary policy. For more specific examples of FOMC actions for various economic scenarios, please refer to The Fed Today lesson plans, p. 40-48. Also, for specific examples of the dangers of inflation, please refer to The Fed Today lesson plans, p. 30.*)
3. After the opening discussion, begin the group activity by stating that students are now going to assume the role of actual FOMC members. You may wish to remind the students that the FOMC uses the economic information and anecdotal evidence gathered by Research economists to assist in the formulation of monetary policy. The information provided in the *Beige Book* is a summary of economic conditions obtained from business contacts, research economists, Bank and branch directors, and market experts. This information, for example, helps FOMC members to determine if there are any risks to the health of the economy such as a downturn in residential housing, inflation or unemployment, just to name a few, or if the U.S. economy is on the path to economic growth. Based on this information, the FOMC will then decide whether or not there will be a corresponding change in the target for the fed funds rate. This ultimately may influence the interest rates that banks charge their customers for loans.
- a. Depending on class size, students will be divided into at least five to as many as 12 groups.
 - b. Each group represents a different Federal Reserve District.
 - c. Each group will provide a summary of the economic conditions of their designated District.
 - d. Each group will identify a group recorder and a spokesperson. All other group members are expected to assist in the drafting of the economic reports.
 - e. Each group is to provide a summary of the economic and anecdotal information contained in the District reports by using these general categories. This information is to be recorded on poster board or the self-adhesive pad sheets provided. Students are to aim for two sentences per category. (*Encourage students to approach it as if they had to come up with a topic sentence or sentences (X2) that summarized the economic information in each category.*)
 - v Consumer Spending
 - v Real Estate and Construction
 - v Banking and Finance
 - v Labor Markets, Prices and Wages(*Please note that these categories may or may not be represented as subheadings in each District. However, typically there is information presented in each District summary that relates to most of these designated categories.*)

- f. Once each group has presented their findings, as a class, students are to determine the outlook for:
 - v Economic Growth
 - v Inflation

Expansion Activity

1. For teachers who have more advanced students, you may wish to have your students consider, given the current economic conditions, what would be the appropriate monetary policy action. (expansion, contraction or no change)

Closure

Discussion Based Activity. To reinforce student understanding of the aforementioned concepts, pose the following questions to your students:

- v What are some examples of economic information sought in the *Beige Book*? *(Students will offer specific examples from each of the following categories: consumer spending, real estate and construction, banking and finance and labor markets, prices and wages. However, there are other categories summarized such as agriculture and natural resources, manufacturing and non-financial services or other business activity. (This exercise only examined four categories in an effort to consider classroom time constraints.)*
- v What is the economic outlook, in your estimation, for retail sales as summarized in the January 2008 *Beige Book* report? *(Retail activity has slowed significantly. In fact, the summary report indicated that retail sales, over the holiday season, were “subdued.” Also specified in the report was that auto sales had weakened. Since consumer spending represents approximately 70 percent of our GDP, this can certainly dampen economic growth. Interestingly enough, the report did mention that the purchase of gift cards increased and that these purchases would not be reflected in the retail sales figures until the cards had been redeemed.)*
- v Based on the anecdotal information collected in the *Beige Book*, what effect has housing and new construction had on the economy? *(Real estate activity across the Districts varied. Some Districts reported weak conditions while others “noted signs of a softening demand.” It is anticipated that “housing markets will remain weak during the first half of 2008.” In addition, rent pricing information was mixed as well. Some Districts reported declines, while others experienced “flat or “stabilized” rates. Home construction had declined according to the Atlanta, Chicago, Dallas, Kansas City and St. Louis reports. Commercial construction activity and development is also expected to maintain a slower pace during 2008.)*
- v What exactly is “credit tightening” and how has it affected financial markets and the U.S. economy in general as evidenced by *Beige Book* information? *[The Districts*

reported business and consumer lending has slowed. Residential lending, on the whole, slowed, while refinancing and commercial lending reports were mixed. Most Districts reported stricter lending standards. "Credit tightening" refers to when banks are more hesitant to lend money. In other words, credit tightening generally implies an increase in interest rates, and/or tougher lending standards. This is due to a variety of factors including; the state of the economy, expected inflation, the value of commercial assets and the credit worthiness of individual consumers, just to name a few. In fact, when federal examiners review banks they consider the following general criteria: capital adequacy, asset quality, management evaluation, earnings, liquidity and sensitivity to market risk. (You may want to discuss with students the recent subprime lending concerns as well as the decline, in some markets, in the value of residential real estate. If you have an advanced class, may want to discuss the volatility of mortgage securities.)]

- v *What is the price outlook for goods and services for all 12 Districts? (You may want to remind students to consider wages too.) (Most Districts responded that businesses had experienced increased prices for "food, petrochemicals, metals and energy-related inputs." Some Districts expressed concern for transportation costs. However, prices for certain goods had actually declined include "lumber, wallboard, and wood panels." Wages, on the whole, remained relatively tight. The demand for skilled workers was pretty strong with few exceptions. Employment costs were generally moderate.)*

Expansion Activity Questions and Responses

- v *Describe the difference between an expansion and a contraction in monetary policy actions. (A contraction in monetary policy refers to when the FOMC raises its target for the fed funds rate. In this instance, the FOMC would direct the New York Domestic Trading Desk to sell government securities (Open Market Operations) to attain the target fed funds rate. The FOMC also typically raises the discount rate in tandem with fed funds target rate. These actions, in turn, may push banks to raise the rates on their loans (mortgages, cars, etc.). The end result is a "tightening of credit." This means consumers may choose not to borrow for purchases and thus, constrain overall consumer spending. An expansion in monetary policy refers to the lowering of the target for the fed funds rate by the FOMC. By lowering the target rate, this may also affect general lending rates. This occurs through the buying of government securities and the lowering of the discount rate. This provides banks with excess reserves and therefore more money for the banks to lend. Banks typically lower their rates in conjunction with FOMC policy. This may, in turn, spark more robust consumer spending. For a more detailed explanation, please refer to The Fed Today lesson plans.)*
- v *Under what circumstances would the FOMC implement expansionary monetary policy? (Expansionary monetary policy is generally implemented during periods of slow to no economic growth. The Federal Reserve System has a dual congressional mandate: to maintain price stability and foster economic growth. In an effort to fulfill*

the mandate, the FOMC may lower the target for the fed funds rate to encourage economic growth. This, in turn, may lead to a lowering of bank interest rates. Lowering interest rates may encourage consumer spending that will promote economic growth. For a more detailed explanation, please refer to The Fed Today lesson plans.)

¹ The Fed Today, lesson plans, p. 38

² →, p. 22

³ →, p. 22

⁴ →, p. 28

⁵ →, p. 65