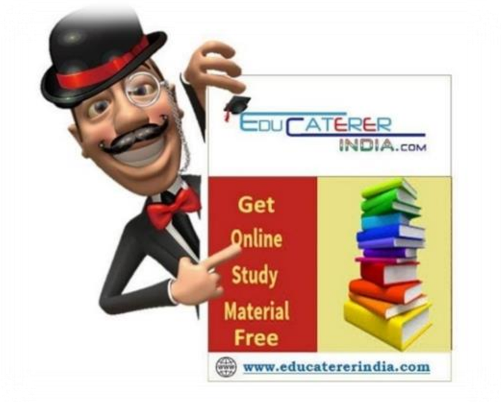
Federal Fund Rate- Explained



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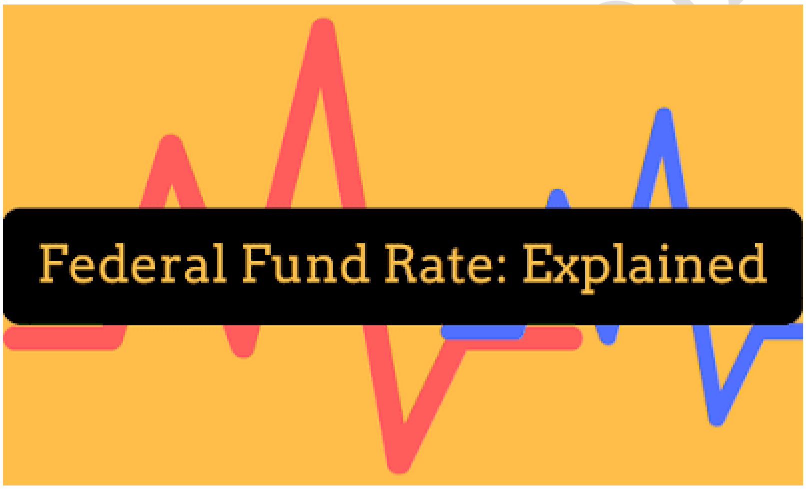

Introduction

Federal Fund Rate is the rate of interest charged in the United States for the use of federal funds. And that is why it is also called popularly as the Federal Funds Rate (FFR). It is one of the few important rates that the central banks of almost all the countries of the world take into consideration before finalizing their monetary policies. It is because of the reason that the USA is the largest capitalist economy and the FFR affects the economies of the whole world and FFR especially affects the Foreign Direct Investments and the flow of capital towards other countries.

Need for FFR

FFR is set by the Federal Reserve Bank, USA that the banks in the United States charge from each other for overnight borrowings. Federal Reserve Bank is the central bank of USA as is Reserve Bank of India in India. Federal Reserve Bank functions and controls the banks in the USA in almost the same way as RBI functions and controls the banks in India. Each and every bank all over the world has to maintain some statutory reserves in proportion to their aggregate deposits. Take for example, the statutory reserve ratio, as 10% of the aggregate deposits; the reserve requirements of all the US based banks change daily due to a lot of transactions of deposits and withdrawals and consequently due to change to in their aggregate deposits and in order to meet their statutory requirements some banks have to borrow funds for overnight and have to pay interest on the funds thus borrowed.

Decision about FFR

It was in 1913 the Federal Fund became an effective central financial support system in the USA. The main functions of the Federal Fund include among others, "Supervision and regulation of the US banking system; to protect the interests of investors and customers of banks, etc; Regulation and stabilization of financial markets; risk control; and elimination of liquidity problems and the provision of funds to credit institutions." Federal Fund Rate is decided by the Federal Open Market Committee (FOMC) members of the Federal Reserve. The meetings of the Federal Reserve are held in routine eight times during a year. However, the US Government by an executive order can call for its extra meeting also. Change in the FFR depends on the state of the US economy. In depth discussions are held before lowering or increasing the FFR.

Key Points

- The current Chairperson of the Federal Reserve is Ms. Janet Yellen and the Vice Chairman is Stanley Fischer
- The last meeting of the Federal Reserve to decide the FFR was held on December 14, 2016 when it raised the FFR by 25 basis points from 0.50 percent to 0.75 percent.

- The rate change meeting was preceded by two-day long discussions of the FOMC headed by Janet Yellen.
- After that a meeting was held on February 1, 2017 in which the FRR was kept unchanged at 0.75 percent.
- The all-time low FFR was 0.25 percent in December 2008. It followed by the hike of 25 basis points on December 16, 2015 to 0.50 percent.
- The all-time high FFR was 20 percent during 1979 to 1980 during the era of double-digit inflation in the USA.