

The Federal Reserve System

American financial power, monetary policy, banking regulation, Wall Street, dollar hegemony, and the global financial order

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Executive Summary

The Federal Reserve is best understood not merely as the central bank of the United States but as the operating core of the dollar financial system. It sits at the junction of four domains: the banking system, Treasury finance, capital markets, and global dollar funding. Its decisions determine the price of overnight money, influence the entire yield curve, shape the supply of bank reserves, stabilize or tighten financial conditions, and transmit through stocks, bonds, housing, corporate finance, commodities, currencies, and emerging markets.

The Fed was created in 1913 because the United States had become an industrial and financial power without a reliable elastic currency or public lender of last resort. The Panic of 1907 exposed this contradiction: a private rescue led by Wall Street could stop a panic, but reliance on J.P. Morgan and clearinghouse improvisation was politically and economically unsustainable. The Federal Reserve Act created a hybrid institution: national public authority through the Board of Governors, regional knowledge through 12 Reserve Banks, and market execution through the New York Fed.

Modern monetary policy is no longer just about changing a single overnight rate. The Fed uses a framework built around administered rates, reserves, open market operations, the discount window, repo and reverse repo operations, central bank swap lines, and balance sheet policy. In crisis, the Fed can expand from rate setter into liquidity backstop and market stabilizer. This power prevents depressions, but it also creates moral hazard, political conflict, asset valuation distortions, and questions about the boundary between monetary policy and fiscal-market support.

As of the June 17, 2026 FOMC statement, the Committee maintained the federal funds target range at 3.50 percent to 3.75 percent, reaffirmed an ample-reserves regime, and said inflation remained elevated relative to its 2 percent goal [10]. That context places the Fed in a high-rate, post-QE, post-inflation-surge operating environment: policy is restrictive enough to discipline inflation, but the central bank must avoid destabilizing Treasury markets, banking liquidity, credit conditions, or global dollar funding.

Core thesis

- The Fed is a price setter for short-term money, not a simple money-printing machine.
- The Fed is a balance-sheet institution: its assets, liabilities, and reserve regime matter as much as its speeches.
- The New York Fed is the operational bridge between Washington policy and Wall Street markets.
- The Fed-Treasury relationship is close but legally distinct: Treasury issues debt and manages fiscal cash; the Fed implements monetary policy and serves as fiscal agent.
- The dollar's global role depends on deep Treasury markets, rule-of-law credibility, global bank balance sheets, and Fed liquidity backstops.
- Every rescue creates a future problem: leverage, asset inflation, moral hazard, political scrutiny, and a larger shadow cast by central-bank liquidity.

1. Why the Federal Reserve Was Created in 1913

The United States before the Fed had banks, capital markets, railroads, industrial corporations, and Wall Street, but it lacked a central mechanism for elastic currency and systemwide liquidity. Banking authority was

fragmented across states, national banks, clearinghouses, and private financiers. During seasonal demand for cash, harvest cycles, war scares, or asset busts, the system could become dangerously illiquid. The result was a recurring pattern: deposit withdrawals, suspension of convertibility, fire sales, and credit contraction.

America's distrust of central banking was rooted in politics as much as economics. The First and Second Banks of the United States were attacked as concentrated financial power. Andrew Jackson's veto of the Second Bank's recharter left a long memory: a central bank could be seen not as a stabilizer but as a privileged, quasi-aristocratic alliance of finance and government. This suspicion shaped the Fed's compromise design: not a single Wall Street bank, not a pure Treasury bureau, and not a fully private bankers' bank.

The Panic of 1907 was the decisive shock. The Federal Reserve History project describes it as the first worldwide financial crisis of the twentieth century and says it helped spur the monetary reform movement that led to the Fed [4]. A key weakness was that trust companies held lower cash reserves than national banks and were outside the main clearinghouse safety mechanisms. When confidence broke, the system needed emergency coordination. J.P. Morgan and other private financiers organized rescue lines, but the very success of that rescue demonstrated the problem: the stability of a national economy depended on private Wall Street power [5].

Congress responded with the Aldrich-Vreeland Act of 1908, emergency currency provisions, and the National Monetary Commission. The Federal Reserve Act of 1913 then institutionalized three principles: elasticity of currency, public oversight, and regional banking representation. The Fed was born from a political bargain between anti-Wall Street populism and the practical need for a modern lender of last resort.

Before the Fed: structural weaknesses

Weakness	Why it mattered
Fragmented reserves	Banks held reserves in correspondent banks, creating pyramids of liquidity that broke under stress.
Inelastic currency	Currency supply could not expand smoothly when seasonal or panic demand for cash rose.
No public lender of last resort	Liquidity depended on clearinghouses and private bankers rather than a public authority.
Regional credit volatility	Agricultural and industrial regions faced different credit needs without a national stabilizer.
Political distrust	Central banking was associated with concentrated financial privilege, forcing a hybrid design.

2. Legal Foundation and Institutional Structure

The Federal Reserve Act is the legal base of the System. The Board of Governors states that the Act established the Federal Reserve System to provide a safer, more flexible, and more stable monetary and financial system, and that the law defines the Fed's purposes, structure, functions, operations, and

accountability [1]. The Act includes provisions on Federal Reserve districts, Reserve Banks, the Board of Governors, the FOMC, open-market operations, reserves, note issue, and monetary policy objectives.

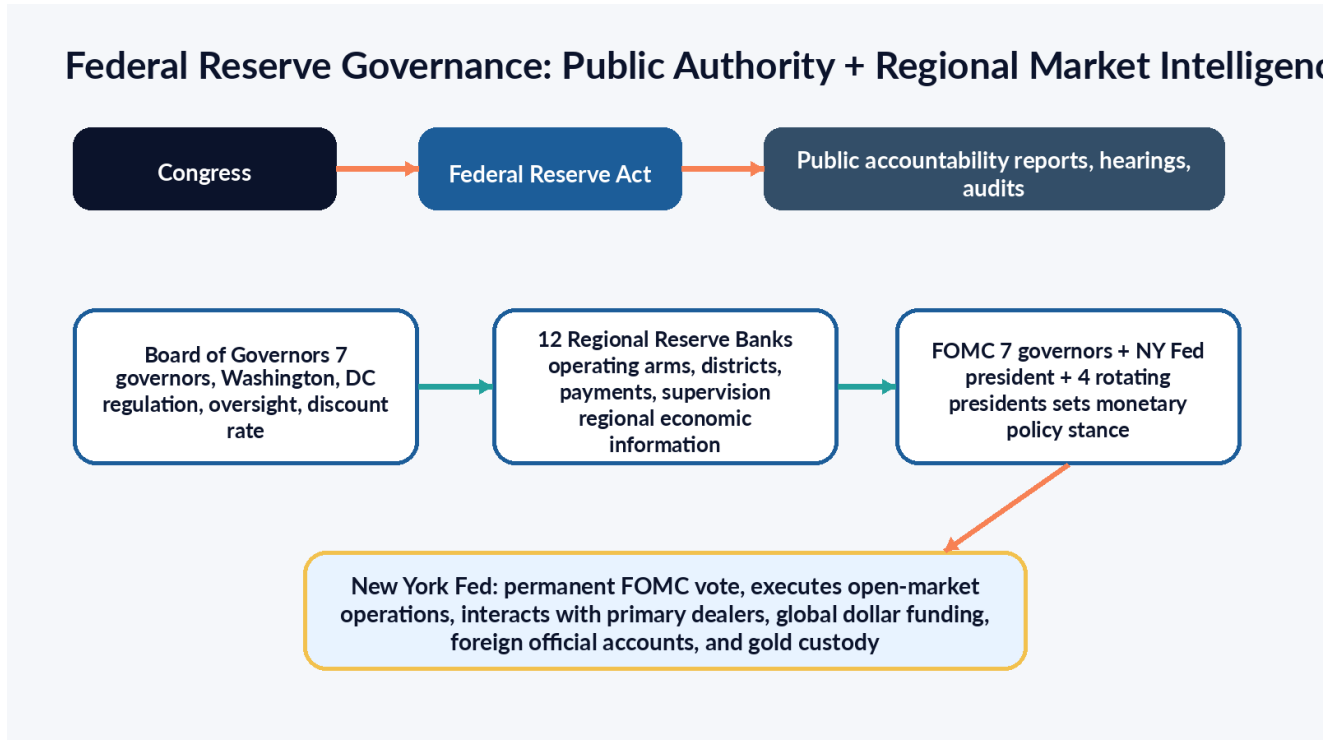


Figure 1. The Fed's structure is a deliberate compromise between public authority, regional information, and market execution.

The Board of Governors

The Board of Governors is a federal agency in Washington, D.C. It is run by seven governors with staggered fourteen-year terms; governors are nominated by the President and confirmed by the Senate. The Board includes a Chair and Vice Chair who serve four-year leadership terms and can be reappointed. The Board guides the System, supervises the Reserve Banks, shares responsibility for bank supervision, and reports to Congress [2].

The 12 Regional Federal Reserve Banks

The Reserve Banks are the operating arms of the System. They perform payments, bank supervision, economic research, community and regional intelligence, financial services, and discount window functions. Their regional structure is essential: monetary policy is national, but the U.S. economy is heterogeneous. A Texas energy shock, a New York market shock, a California technology shock, and a Midwest agricultural credit shock do not look the same.

The FOMC

The Federal Open Market Committee is the monetary policy body. It consists of 12 voting members: the seven governors, the president of the Federal Reserve Bank of New York, and four of the other 11 Reserve Bank presidents on a rotating basis. Nonvoting Reserve Bank presidents attend meetings and contribute to discussions. The FOMC normally holds eight scheduled meetings a year [3].

The Chair

The Chair is not a dictator. The Chair is the agenda setter, chief communicator, consensus builder, and public face of the FOMC. The Chair's power comes from institutional leadership, control over communication, Board influence, and market credibility. In modern markets, a Chair's press conference can move yield curves, equity multiples, the dollar, and volatility because it shapes the expected path of future policy.

The New York Fed's special role

The New York Fed is unique because it is both a regional Reserve Bank and the operating arm closest to global capital markets. It has a permanent FOMC vote. It conducts operations in global financial markets to support monetary policy and financial stability objectives and provides services including foreign official accounts and gold custody [7]. Its trading desk executes open market operations, repos, reverse repos, Treasury and agency MBS transactions, and dollar liquidity operations. This makes the New York Fed the bridge between the FOMC's decisions and the actual plumbing of Wall Street.

3. How the Fed Controls Money and Credit

The Fed does not control every dollar in the economy directly. It controls the marginal price and availability of central-bank money: reserves and cash. Through that anchor, it influences the price of private credit. The key channel is the federal funds rate, the overnight rate at which banks and other eligible institutions lend balances held at the Fed. The Fed states that changes in the federal funds rate affect short-term rates, foreign exchange, long-term rates, money and credit, employment, output, and prices [3].

How the Fed Controls Money and Credit

The policy rate is a price of overnight money. It moves the whole term structure of finance.

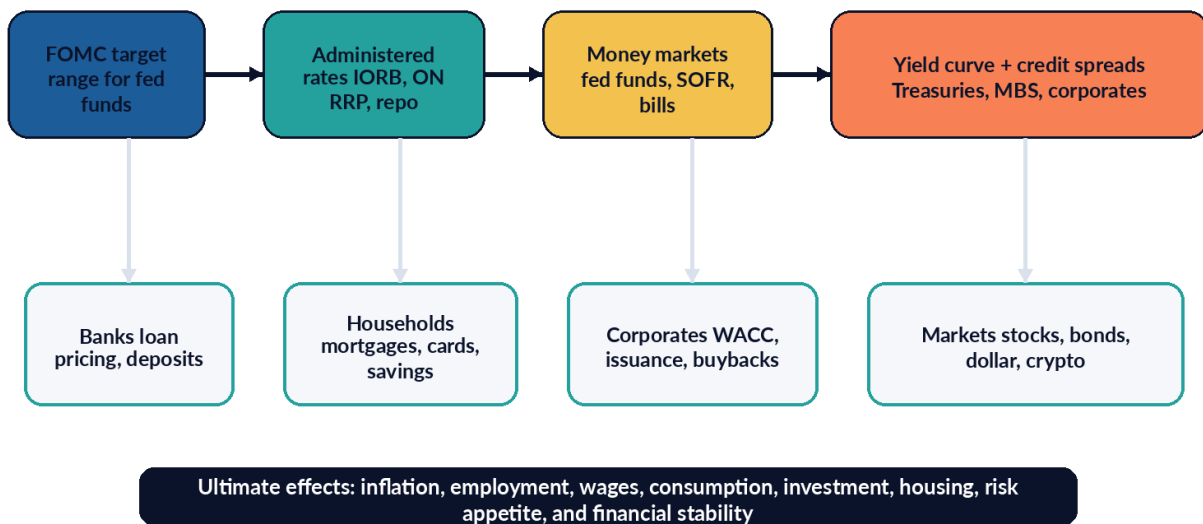


Figure 2. Monetary policy transmission: from the FOMC target range to real economic and market outcomes.

Target rate and federal funds rate

The FOMC sets a target range, not a single point. As of the latest Fed policy release used for this report, effective June 18, 2026, the target range was 3.50 percent to 3.75 percent [10]. The Fed then uses administered rates and market operations to keep the effective federal funds rate inside that range.

Open market operations

Open market operations are purchases and sales of securities, outright or through repurchase agreements. Historically, the Fed adjusted scarce reserves through Treasury transactions. In the current ample-reserves framework, open market operations also maintain reserves, manage market functioning, and support the target range through the New York Fed's Desk [8].

Reserve requirements

Reserve requirements used to force banks to hold a certain ratio of reservable deposits as balances at the Fed or vault cash. Their importance declined as the Fed shifted to an ample-reserves regime. The concept remains important historically: it shows that the central bank's power works through bank balance sheets, liquidity management, and the reserve base of the payments system.

Interest on reserve balances, discount window, repos, and reverse repos

Today, the Fed controls money-market rates mainly with administered rates. Interest on reserve balances sets a floor under the rate banks are willing to accept for lending reserves. Overnight reverse repos give money market funds and other eligible nonbanks a risk-free alternative, helping put a floor under broader overnight rates. Standing repo operations can limit upward pressure by offering collateralized funding. The discount window supplies liquidity to depository institutions and can reduce panic-driven credit contractions [8].

QE, QT, and balance sheet policy

Quantitative easing is large-scale asset purchasing, usually used when short-term rates are near the effective lower bound. Its goal is not merely to create reserves; it removes duration and sometimes MBS risk from the market, lowers term premiums, supports asset prices, and eases financial conditions. Quantitative tightening does the reverse: the Fed allows assets to mature or run off, reducing reserves and returning duration supply to the market. The Fed's balance sheet grew from about \$800 billion in December 2005 to roughly \$6.5 trillion in December 2025, reflecting crisis-era QE and the shift to an ample-reserves regime [11].

Balance sheet policy is now central to monetary policy. A small balance sheet may reduce the Fed's market footprint, but too few reserves can create money-market volatility. A large balance sheet supports rate control and liquidity resilience but can blur the line between central banking and market allocation. This is why the balance sheet has become a political economy issue, not just a technical operating detail.

4. The Dual Mandate: Price Stability and Maximum Employment

The Federal Reserve Act instructs the Fed to conduct monetary policy to promote maximum employment, stable prices, and moderate long-term interest rates. The Fed explains that this is commonly called the dual mandate because maximum employment and stable prices are the two operational goals [9]. Stable prices are interpreted through the FOMC's 2 percent longer-run inflation objective. Maximum employment is not a fixed

number; it is an assessment of the strongest labor market consistent with price stability.

In practice, the dual mandate is a balancing framework. If inflation is high, the Fed tightens credit even if unemployment may rise. If unemployment is high and inflation is subdued, it eases policy. The difficulty comes when inflation and labor-market weakness appear together, as in supply shocks. Then the Fed must decide whether inflation expectations are at risk of de-anchoring and whether unemployment pain is an acceptable cost of restoring credibility.

Transmission to the real economy

- Unemployment: higher rates slow hiring by raising corporate financing costs and weakening demand.
- Wages: tight policy can cool wage growth by reducing labor demand; easy policy can raise labor bargaining power but may also feed inflation.
- Consumption: credit cards, auto loans, and confidence are rate sensitive; savings income may rise for cash holders.
- Investment: higher discount rates reduce the present value of long-lived projects and make debt-financed expansion more expensive.
- Housing: mortgage rates and affordability are among the strongest consumer-facing policy channels.
- Corporate finance: rate hikes reprice investment-grade debt, high-yield debt, leveraged loans, IPOs, buybacks, and M&A.;

Inflation response

Inflation is the Fed's credibility test. If households and businesses believe the Fed will defend purchasing power, inflation expectations remain anchored and the cost of disinflation can be lower. If expectations break, the Fed may need a harsher tightening cycle. The June 2026 FOMC statement said inflation remained elevated relative to the Committee's 2 percent goal, illustrating that the post-pandemic inflation regime had not fully disappeared [10].

5. Relationship with Treasury, Banks, Wall Street, and Global Institutions

The Fed operates inside a network. Its formal independence is about monetary-policy decisions, but its effectiveness depends on the Treasury market, commercial banks, primary dealers, money market funds, foreign central banks, and institutional investors.

Institution	Relationship with the Fed	Strategic meaning
U.S. Treasury	Treasury issues debt and manages fiscal cash; the Fed serves as fiscal agent and holds Treasury securities for monetary policy.	Government debt is the collateral base of dollar finance.
Commercial banks	Hold reserves, access discount window, transmit deposit and lending rates.	Banks turn central-bank money into private credit.
Investment banks / primary dealers	Trade with the New York Fed Desk in open-market operations.	Wall Street is the execution channel for Treasury and liquidity operations.

Hedge funds	Affected through leverage costs, repo financing, volatility, Treasury basis trades, and risk appetite.	Fed policy shapes relative-value trades and forced deleveraging risk.
Pension funds / insurers	Sensitive to long rates, duration, credit spreads, asset-liability matching.	Fed policy affects solvency math and portfolio allocation.
Money market funds	Use ON RRP and Treasury bills; help transmit the floor system to nonbanks.	Shadow banking is now part of monetary transmission.
Foreign central banks	Use dollar swap lines, FIMA repo, custody, and dollar reserve channels.	The Fed is a global dollar liquidity backstop.

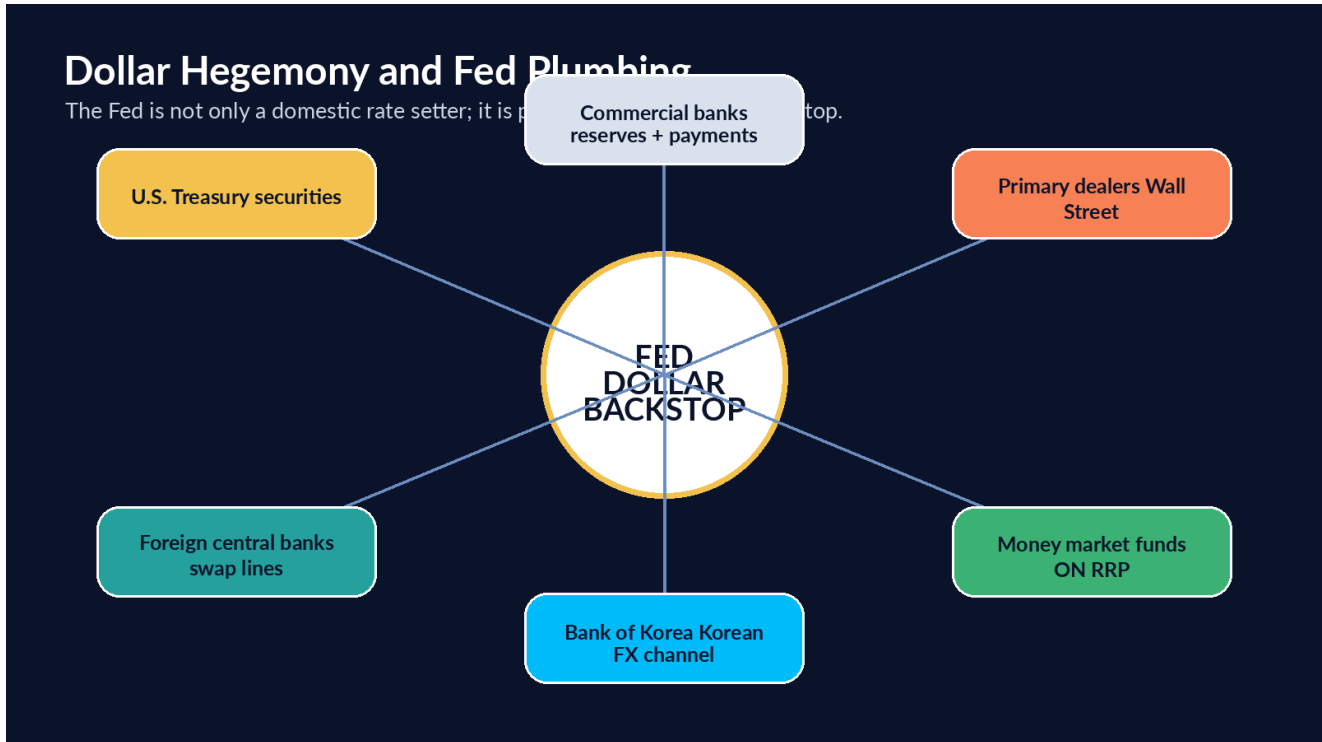


Figure 3. Global dollar plumbing: the Fed's domestic tools also support international dollar funding markets.

The Treasury relationship is especially delicate. The Fed is not supposed to be a fiscal financing arm, yet the Treasury market is the core asset market through which monetary policy works. The Treasury General Account is the Treasury's account at the Fed, and the size of that account is determined by Treasury, not the Fed [12]. Meanwhile, central bank liquidity swap lines allow foreign central banks to deliver dollars into their jurisdictions during stress, reducing the risk that foreign dollar funding problems spill back into U.S. markets [13].

6. Case Studies: Rescue Power and New Risks

From Lender of Last Resort to Market Maker of Last Resort

Crisis interventions stop fire sales, but can raise moral hazard and duration-risk questions.

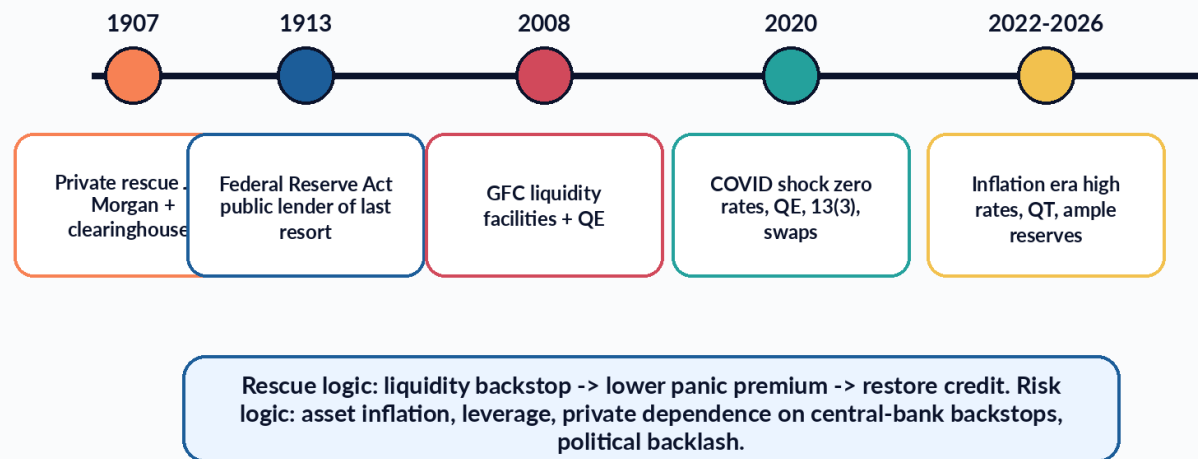


Figure 4. The Fed's crisis role evolved from lender of last resort to market-stability backstop.

2008 global financial crisis

The 2008 crisis showed that the financial system had moved far beyond traditional commercial banking. The panic ran through repo, mortgage securities, investment banks, money market funds, derivatives, and shadow banking. The Fed responded with emergency lending facilities, support for liquidity in financial institutions and markets, and large-scale asset purchases. Its own crisis-response materials state that these programs supported liquidity and improved market conditions while changing the Fed's balance sheet [6].

The rescue worked in the narrow sense that the payment system and core credit markets did not collapse into a second Great Depression. But it changed the public perception of the Fed. The central bank appeared to rescue Wall Street faster than households. It also established a precedent: when the market structure becomes systemically important, the Fed may support market functioning even if the crisis originated outside traditional banks.

COVID-19 crisis

COVID-19 was not a credit-cycle crisis at first; it was a sudden stop in economic activity that became a market liquidity crisis. The Fed cut rates, restarted massive asset purchases, opened emergency facilities, supported money markets and corporate credit, and expanded dollar swap lines. Swap lines with the Bank of Korea and other foreign central banks were announced in March 2020 to lessen strains in global dollar funding markets [14].

The upside was speed: the Fed prevented a health shock from becoming a financial-system collapse. The downside was that the recovery combined monetary easing, fiscal transfers, supply constraints, and reopening demand. This helped create the conditions for the inflation surge and later high-rate correction.

Inflation surge

The inflation surge forced the Fed to pivot from market rescue to inflation fighting. The key political economy lesson is that central banks gain popularity when they support asset prices and employment but lose popularity when they raise borrowing costs to restore price stability. Inflation also exposed distributional tensions: renters, wage earners, savers, homeowners, asset owners, and leveraged firms experience the same policy differently.

High-interest-rate era

The high-rate era pressures every leveraged balance sheet. Banks face deposit competition and securities losses; private equity faces refinancing risk; commercial real estate faces cap-rate repricing; households face mortgage unaffordability; Treasury faces higher debt-service costs; and emerging markets face dollar pressure. Yet high rates also restore the price of money, reward cash savers, discipline speculative valuations, and rebuild the Fed's inflation credibility.

New risks created by rescue

- Moral hazard: investors may assume liquidity backstops will return in every crisis.
- Asset inflation: low rates and QE can raise valuations faster than incomes.
- Shadow-banking dependence: nonbanks become central to monetary transmission but sit outside the traditional safety net.
- Treasury-market fragility: the most important collateral market can still face liquidity stress.
- Political pressure: large Fed interventions blur the line between technocratic monetary policy and distributional choices.
- Exit problem: withdrawing stimulus can be harder than providing it because markets adapt to abundant liquidity.

7. Market Impact: Stocks, Bonds, Dollar, Gold, Oil, Real Estate, Bitcoin, EM, Korea

Asset-Class Transmission Map

A Fed move is not one signal; it changes discount rates, liquidity, leverage, currency, and risk premia.

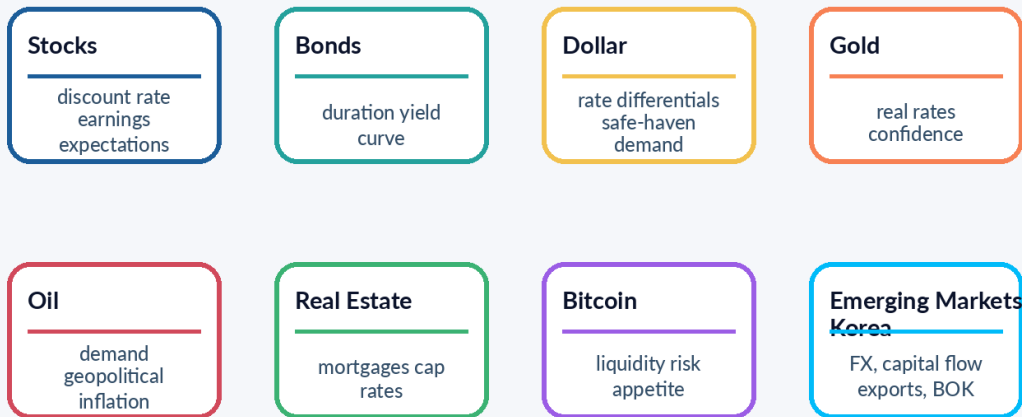


Figure 5. Fed policy affects every major asset class through discount rates, liquidity, leverage, currency, and expectations.

Stock market

Equities respond through discount rates, expected earnings, liquidity, and risk appetite. Lower rates raise the present value of future cash flows and often support high-duration growth stocks. Higher rates compress multiples, raise hurdle rates, and expose weak balance sheets. But the signal is not mechanical: if the Fed cuts because recession risk is rising, stocks may fall despite lower rates.

Bond market

Treasuries are the direct transmission channel. Short maturities follow expected policy rates; long maturities reflect expected future short rates, inflation expectations, term premium, and Treasury supply-demand. Corporate bonds add credit spreads. MBS add prepayment and convexity risk, which is why Fed MBS purchases can have powerful housing-market effects.

U.S. dollar

The dollar usually strengthens when U.S. real rates rise relative to other economies or when global stress creates safe-haven demand. The Fed's dollar swap lines and FIMA repo facility reinforce dollar hegemony by showing that the dollar system has a central liquidity backstop in crisis. But dollar power also depends on fiscal credibility, Treasury-market depth, legal predictability, and U.S. geopolitical trust.

Gold

Gold competes with real yields and dollar confidence. When real rates rise, gold's opportunity cost rises. When financial or geopolitical confidence falls, gold can rise even during high-rate periods. Gold is therefore not simply an inflation hedge; it is also a hedge against monetary, fiscal, and geopolitical distrust.

Oil

The Fed does not pump oil, but it affects oil through the dollar, global demand, inflation expectations, inventories, and risk appetite. Tight policy can cool demand and strengthen the dollar, often weighing on oil. Supply shocks can raise oil prices and inflation at the same time, creating a difficult policy tradeoff.

Real estate

Real estate is one of the most rate-sensitive sectors. Mortgage rates affect affordability, transaction volume, and homebuilder demand. Commercial real estate is repriced through cap rates, refinancing costs, and lender risk appetite. The Fed's effect is amplified because real estate uses leverage and long-duration cash flows.

Bitcoin and digital assets

Bitcoin trades partly as a liquidity and risk-appetite asset, partly as a monetary-debasement narrative, and partly as a technology/speculation asset. Tight Fed policy usually reduces speculative leverage. But distrust in fiat institutions can support Bitcoin's long-term narrative. The result is high sensitivity to both liquidity and political-monetary psychology.

Emerging markets

Emerging markets are exposed through dollar debt, portfolio flows, commodity prices, and local central-bank constraints. A stronger dollar and higher U.S. yields can pressure EM currencies and force tighter policy even when local growth is weak. Fed easing can reopen capital flows, lower funding costs, and support risk assets.

Korean economy

Korea is exposed through the won-dollar exchange rate, foreign equity and bond flows, export competitiveness, energy import costs, household debt, and the Bank of Korea's policy constraints. A hawkish Fed can weaken the won, raise imported inflation, and pressure Korean rates. A dovish Fed can ease FX pressure and support risk appetite toward Korean equities, especially semiconductor and export-linked sectors. During COVID-19, the Fed established temporary dollar liquidity swap lines that included the Bank of Korea, showing how Korea can be directly connected to the Fed's global dollar backstop in market stress [14].

8. Essential Concepts

Concept	Meaning	Why it matters
Federal funds rate	Overnight unsecured interbank/reserve-market rate.	Anchor for short-term money and policy expectations.
Target range	FOMC's desired range for fed funds.	The Fed steers a market rate rather than commanding every loan rate.
Reserves	Deposits of banks at the Fed.	Base liquidity for payments, bank safety, and policy implementation.
IORB	Interest paid on reserve balances.	Main floor tool in an ample-reserves system.

ON RRP	Fed reverse repo facility for eligible nonbanks.	Extends the rate floor to money market funds and cash investors.
Discount window	Fed collateralized lending to depository institutions.	Classic lender-of-last-resort tool.
Open market operations	Fed purchases/sales/repos involving securities.	Operational mechanism for rate control and balance sheet management.
QE	Large-scale asset purchases.	Lowers term premium and supports financial conditions when rates are constrained.
QT	Balance sheet runoff or asset reduction.	Withdraws reserves and returns duration to the market.
Dual mandate	Maximum employment and price stability.	Defines the policy tradeoff between labor strength and inflation control.
Term premium	Extra yield for holding longer-maturity bonds.	Critical for mortgages, equity valuations, and Treasury finance.
Dollar swap lines	Fed dollar liquidity arrangements with foreign central banks.	Backstop for global dollar funding markets.

9. Recommended Study Sequence

A professional understanding of the Fed should be built in layers. Do not start with ideology. Start with plumbing, then macroeconomics, then markets, then political economy.

Step	Study focus	Core question
1	Balance sheets	What are Fed assets, liabilities, reserves, currency, and the Treasury General Account?
2	Banking system	How do deposits, reserves, capital, liquidity, and the discount window interact?
3	Money markets	How do fed funds, repo, SOFR, bills, IORB, and ON RRP connect?
4	FOMC process	How do data, forecasts, votes, statements, minutes, and press conferences shape expectations?
5	Inflation and labor	How does policy balance price stability with employment and wages?
6	Treasury market	Why is the Treasury curve the global discount-rate benchmark?
7	QE/QT	How does the Fed's balance sheet change term premium, reserves, and risk appetite?
8	Crisis facilities	When does the Fed move from rate setter to liquidity backstop?
9	Asset classes	How does policy transmit into equities, credit, real estate, commodities, and crypto?
10	Global dollar system	How do swap lines, FIMA repo, foreign reserves, and EM dollar debt connect the world to the Fed?

11	Political economy	Who gains, who loses, and how does independence survive democratic pressure?
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Best first reading order: Federal Reserve Act and Fed structure pages; FOMC statements and implementation notes; New York Fed policy implementation; H.4.1 balance sheet release; Fed History essays on 1907 and 1913; crisis-response pages; then advanced research on QE, QT, reserves, and the global dollar system.

Conclusion

The Fed is the institutional center of American monetary power. It controls the price of reserves, but its influence extends into the price of houses, the level of stock multiples, the cost of corporate debt, the value of the dollar, the resilience of banks, the funding of the Treasury market, and the stability of global dollar finance. Its power is strongest in crisis, when private balance sheets need a public backstop. Its legitimacy is most vulnerable after crisis, when people ask why financial markets were rescued and who paid the cost.

To understand the Federal Reserve, study it as a system: law plus balance sheet, committee plus market desk, banks plus shadow banks, domestic mandate plus global dollar role, price stability plus financial stability, independence plus political accountability. That is the real Federal Reserve: not a building, not only a Chair, and not simply a central bank, but the operating architecture of dollar capitalism.

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Note: The diagrams in this report are original explanatory illustrations created for this document. They are not official Federal Reserve graphics.