# Monetary Policy

Monetary policy refers to the ability of the central bank to stimulate or cool off the economy by increasing or decreasing the money supply. The U.S. central bank, the Federal Reserve, affects the money supply three different ways: by reducing or increasing the required reserve requirement; by reducing or increasing the discount rate (i.e. the rate at which depository institutions can borrow from the Fed); by engaging in open market operations.

In practice, changing the reserve requirement is rarely used because the Fed believes it is too crude a tool for active monetary policy. The discount rate is used more frequently, but mainly in response to what is already going on in the market and in response to current Fed policy. The tool most often used is open market operations.