Open Market Operations

Open market operations are one of the three ways the Federal Reserve can control the money supply of the U.S. economy. Open market operations are the buying and selling of securities (usually short-term T-Bills) in the open market to increase or decrease the money supply. An increase in the money supply reduces interest rates and stimulates the economy. A decrease in the money supply increases interest rates and cools off the economy.

Of the three ways the Fed can affect the money supply (changing the reserve requirement, change the discount rate, engage in open market operations), open market operations are the one most frequently used by the Fed.

The Federal Reserve feels an open market operation is a precision tool that allows it to fine tune its policy. Also, since the Fed is regularly buying and selling securities in the open market, it is the option that best allows it to temporarily mask its policy objectives.