

Federal Reserve

Overview: Federal Reserve

Federal Reserve (Fed) chair Jerome Powell's term ended in May 2026. The Senate confirmed President Trump's nominee, Kevin Warsh, and he was sworn in on May 22. Throughout the process, questions arose about the Federal Reserve's role, how it functions, and its impact on the economy, prices, and the workforce.

The Federal Reserve raised interest rates and reduced its balance sheet to slow price increases after the economic disruptions of the COVID-19 pandemic and the subsequent inflation surges. As labor market conditions softened and inflation slowed (but remained above the Fed's target), the Federal Reserve began easing policy. In 2025, the Fed lowered the federal funds target rate three times, bringing it to a range of 3.5% to 3.75%. It also began expanding its balance sheet after a reduction period that lasted from March 2023 through December 2025. The Fed expands its balance sheet by buying securities and reduces its balance sheet by either selling securities or not reinvesting once its securities mature.

This chapter summarizes the Federal Reserve's role in the economy, the tools it uses to carry out monetary policy, and recent trends in inflation and employment that shape those policy decisions.

Data summary

- Inflation has slowed but has remained above the Fed's target of 2% since 2021, with the Personal Consumption Expenditures (PCE) price index (the Fed's preferred inflation metric) averaging about 2.6% in 2025. As of January 2026, inflation was 2.8%.
- The unemployment rate rose to an average of 4.3% in 2025, a second consecutive annual increase, though it remained below long-term historical averages. Unemployment was 4.4% in February 2026.
- The employment-to-population ratio for adults ages 25–54 is near historic highs, but has recently declined. It averaged 80.6% in 2025, about 1 percentage point below its 2000 peak after declining for the first time since 2020.
- The Federal Reserve began easing monetary policy in 2025 due to slowing inflation and a softening labor market. The Fed lowered the federal funds target range three times during the year, bringing it to 3.5%–3.75%. It began expanding its balance sheet in mid-December 2025 after reducing it from March 2023 through early December 2025.

What is the Federal Reserve?

The Federal Reserve (Fed) is the US central bank, created by the Federal Reserve Act of 1913. It was initially created to address banking crises, but now it is charged with several broader responsibilities to promote a healthy economy:

Federal Reserve responsibilities

- 1

Conduct monetary policy (dual mandate)
- 2

Promote stability in financial system
- 3

Supervise and regulate financial institutions
- 4

Foster payment system safety
- 5

Promote consumer protection

Source: Federal Reserve System

How is the Fed structured?

The Federal Reserve System has three parts: the Board of Governors (Board), 12 Federal Reserve Banks, and the Federal Open Market Committee. The Board is an independent federal agency that reports to, and is directly accountable to, Congress. This means the Board must explain, justify, and report its actions to Congress, though it makes policy decisions independently. The Chair of the Board of Governors typically chairs the Federal Open Market Committee, with the president of the New York Federal Reserve Bank serving as Vice Chair.

Federal Reserve structure

Body	Number of members	Term length	Nominated by	Accountable to
Board of Governors (Board)	Seven governors; including a Chair and Vice Chair	14 years for governors; Chair and Vice Chair can serve additional four-year terms	US President	US Congress
12 Federal Reserve Banks	12 presidents	Five years	Board of Governors	Directors of corresponding district bank
Federal Open Market Committee (FOMC)	12 voting members (including Board, president of the New York Fed, and four bank presidents*) Chaired by the Board Chair and the NY Fed president as Vice Chair	Board and New York President are permanent members One-year terms for presidents on rotating basis	US President (Board members) and Board of Governors (bank presidents)	US Congress (through the Board of Governors)

Source: Federal Reserve System
*The remaining seven Reserve Bank presidents attend the FOMC meetings and participate in deliberations but do not vote.

To what extent is the Fed independent?

Although Congress oversees the Federal Reserve, it is designed to operate with policy independence from day-to-day political direction. The Fed was established with structural characteristics that contribute to its independence:

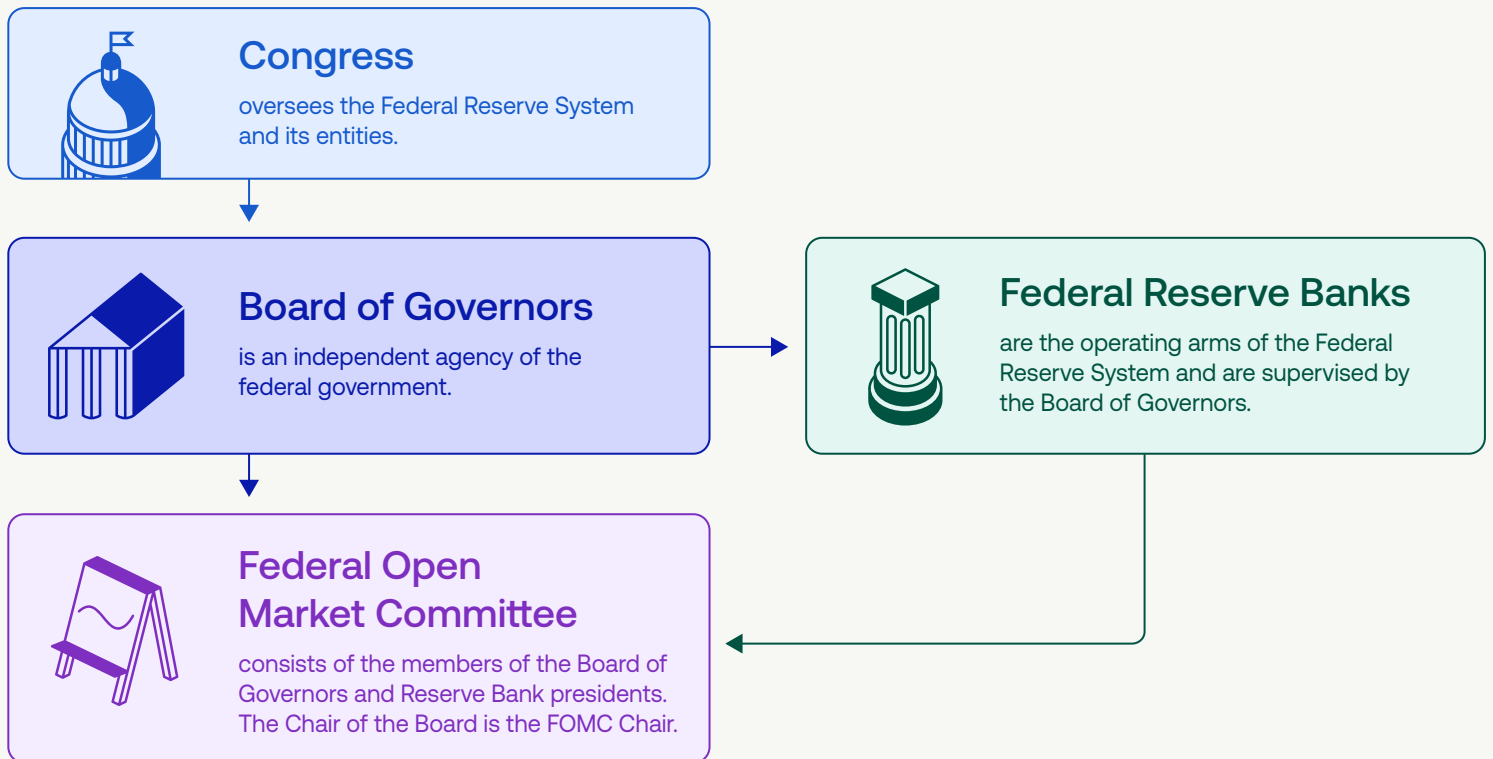
- The Fed is self-funded and not subject to appropriations. It funds its operations primarily through interest earned on its securities holdings.
- The governors who lead the Board serve long, fixed terms and may be removed only “for cause.”
- The Fed’s regional bank presidents are not appointed by the president, and the Fed’s policies are not subject to Office of Management and Budget (OMB) review.

Independence is supported by longstanding institutional practices that emphasize nonpartisan, consensus-based decision-making.

What are the responsibilities of the Board of Governors?

The Board guides the Federal Reserve System’s operations to fulfill its goals and responsibilities. It oversees the operations of the 12 Federal Reserve Banks, with which it shares responsibility for supervising and regulating financial institutions and activities. The governors are also automatic members of the Federal Open Market Committee.

Federal Reserve entities

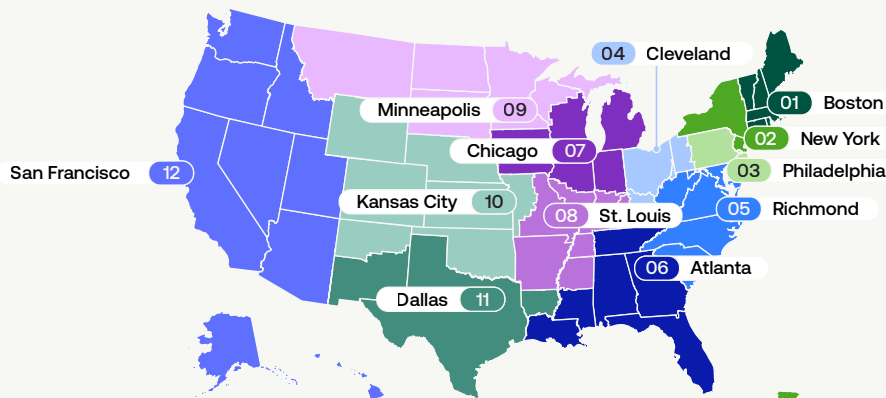


Source: Adapted from Federal Reserve System

What are the responsibilities of the 12 Federal Reserve Banks?

The Reserve Banks are the operating arms of the Federal Reserve System, and each operates within its geographic area. The banks supervise and examine financial institutions, enforce compliance with existing laws, promote local community development, and lend to institutions to ensure liquidity in the financial system. They also distribute currency and coins to banks, operate electronic payment systems, and serve as the government's bank. Notably, they provide the Board with information on economic conditions to inform policy that maintains a healthy economy and financial system.

The 12 Federal Reserve Banks



Source: Federal Reserve Bank of Kansas City

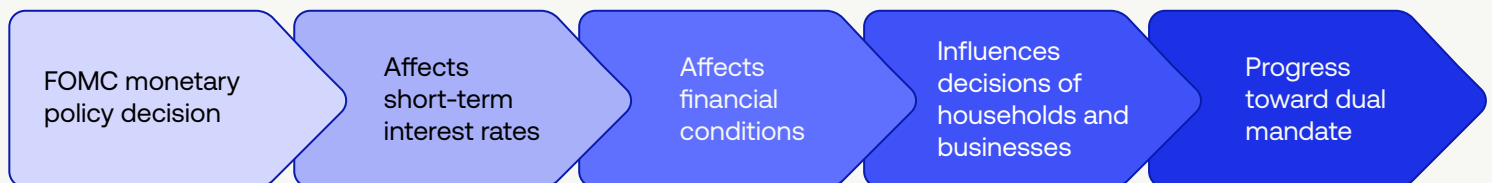
Note: The New York Federal Reserve Bank serves the Commonwealth of Puerto Rico and the US Virgin Islands. The San Francisco Bank serves American Samoa, Guam, and the Commonwealth of the Northern Mariana Islands.

What are the responsibilities of the Federal Open Market Committee?

Congress tasked the Fed with a dual mandate: to promote maximum employment and stable prices. To pursue these goals, the Fed conducts monetary policy, primarily through the Federal Open Market Committee (FOMC).

The FOMC influences financial conditions in three main ways: 1. affecting interest rates, 2. managing its balance sheet, and 3. communicating about the future path of policy. Through these avenues, monetary policy influences households' and businesses' decisions, thereby affecting overall spending, lending, investment, production, employment, and inflation in the US.

Federal Open Market Committee intended chain of events

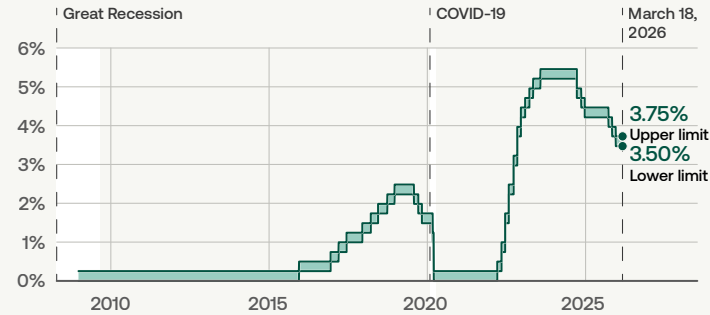


Source: Adapted from Federal Reserve System

How does the Fed change interest rates?

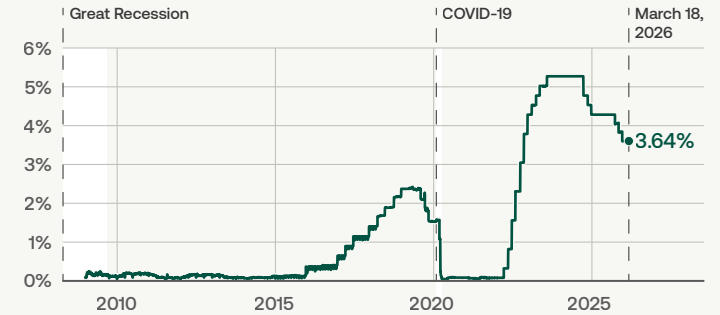
When necessary, the Fed adjusts monetary policy. It does this primarily by raising or lowering its target range for the federal funds rate, which is an interest rate for overnight borrowing between banks. Transactions in this market typically occur within the target range, and the average rate across all overnight transactions is known as the “effective federal funds rate.”

Federal funds target range



Source: Federal Reserve Bank of St. Louis

Effective federal funds rate



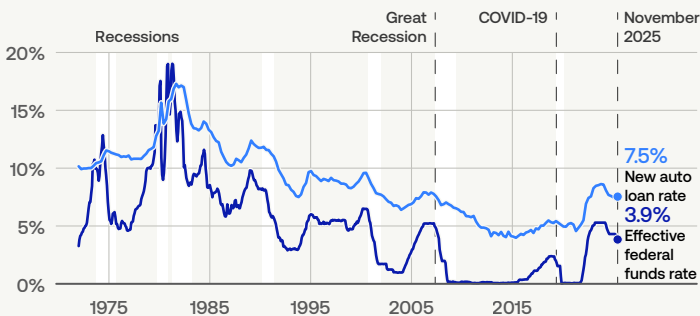
Source: Federal Reserve Bank of St. Louis

How does the federal funds rate affect short-term interest rates?

When the Fed lowers the federal funds rate target range, short-term borrowing becomes cheaper for banks, which can make it easier for them to extend credit to households and businesses. Lower borrowing costs can increase demand for loans, which supports spending, investment, and employment. The Fed typically uses this approach during periods of economic weakness. For example, during the COVID-19 pandemic, the target range was reduced to near zero.

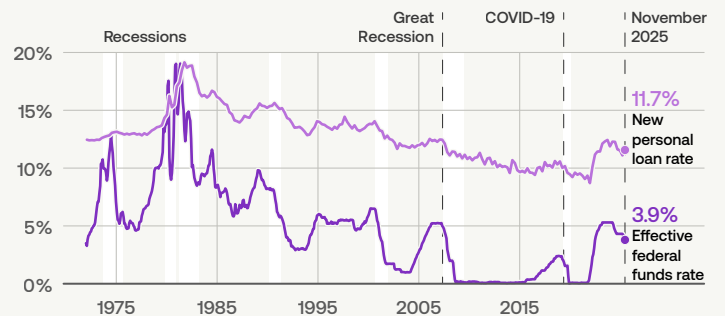
When the Fed raises the target range, borrowing becomes more expensive. Higher interest rates tend to reduce loan demand, slow spending and investment, and help limit price increases. The Fed may raise rates when inflation is elevated, as it did in 2022. Interest rates on consumer loans, such as auto loans and personal loans, often rise and fall alongside changes in the federal funds rate, reflecting shifts in borrowing costs.

Commercial bank rate on new 48-month auto loans vs. monthly effective federal funds rate



Source: Federal Reserve Bank of St. Louis

Commercial bank rate on new 24-month personal loans vs. monthly effective federal funds rate



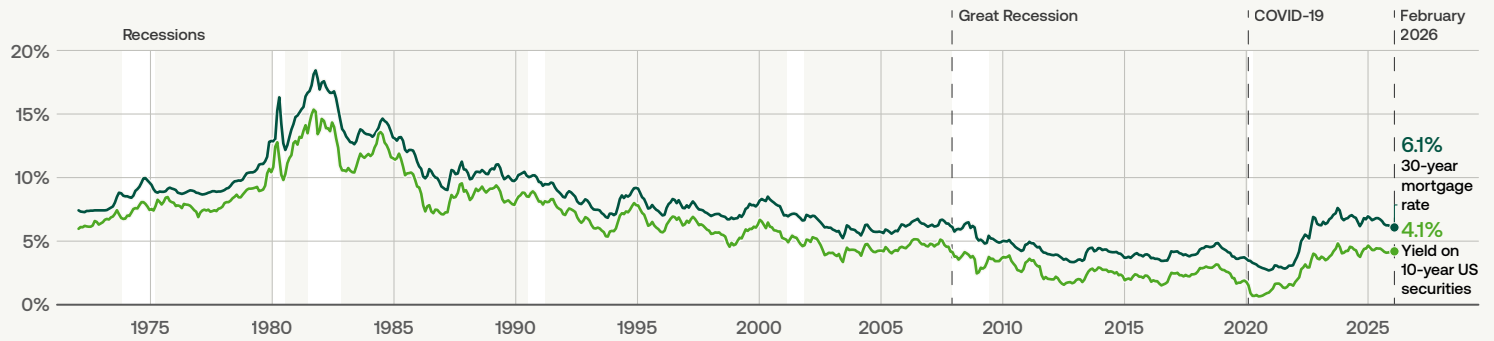
Source: Federal Reserve Bank of St. Louis

How does the Federal Reserve influence long-term interest rates?

Expectations about future Fed policy affect longer-term borrowing costs. Those expectations are reflected in yields on longer-term Treasury securities. As expectations about future interest rates, inflation, or economic conditions change, the 10-year yield moves as well. Many long-term borrowing rates — such as the 30-year fixed mortgage — tend to move in the same direction.

Yield on 10-year Treasury securities vs. 30-year mortgage rate

Monthly average



Source: Federal Reserve Bank of St. Louis

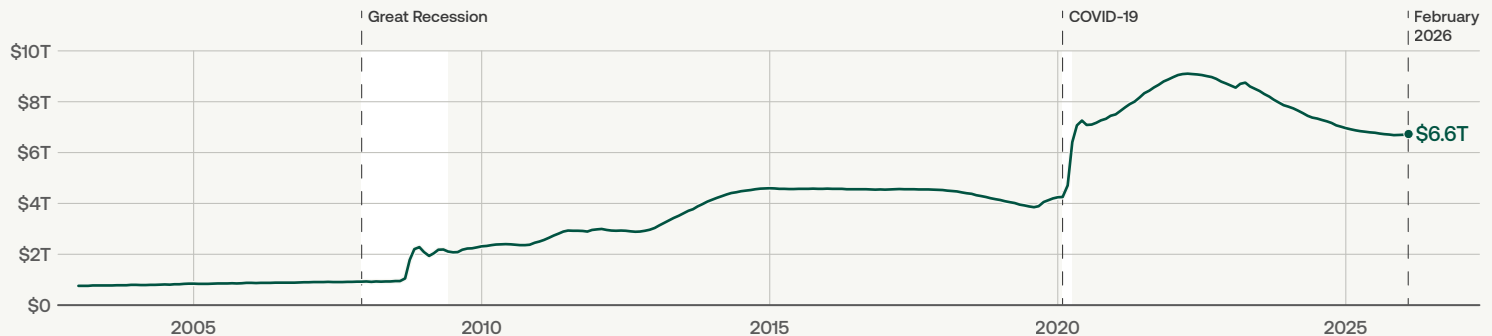
What does the Fed do when changing interest rates is not enough?

When interest rates are already very low, or when financial markets are under stress, rate changes alone may not be enough to influence broader financial conditions. In these instances, the Fed can buy and sell securities, called “open market operations.” When the Fed buys government securities, also known as “expanding its balance sheet,” it increases demand for those bonds, which raises their prices and lowers their yields, helping reduce long-term interest rates across the economy. This can make borrowing cheaper for households and businesses even when short-term rates are near zero. The Fed used this approach during the COVID-19 pandemic, rapidly expanding its balance sheet to support financial markets and help keep borrowing costs low.

When inflation rose post-COVID-19, the Fed reduced its balance sheet to help take money out of the banking system, raise long-term interest rates, and make borrowing more expensive for households and businesses. The amount of securities the Fed holds remains elevated above pre-pandemic levels, however.

Federal Reserve total net assets

Monthly average



Source: Federal Reserve Bank of St. Louis

What other tools does the Fed use to change monetary policy?

The Fed may also influence economic conditions by communicating future policy paths. Because many financial decisions in the private sector depend on expectations of future interest rates, signals from the Fed about how it may respond to economic conditions can affect financial markets even before any policy changes.

For example, during the pandemic, the Fed stated its intention to keep interest rates near zero until economic conditions improved. This shaped expectations about future policy. As inflation rose after the pandemic, the Fed also signaled that it would begin raising interest rates, preparing the markets for a gradual tightening of policy to help limit price increases.

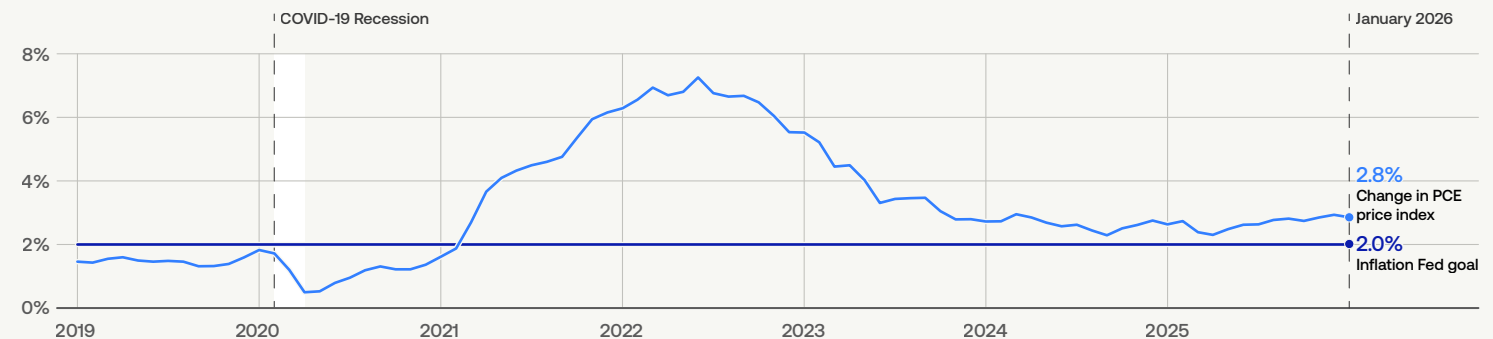
Evaluating the dual mandate: Price stability

To assess price stability, the Fed has stated a longer-run inflation objective of 2% as measured by the Personal Consumption Expenditures (PCE) price index; however, this is not set in law. Although inflation can be measured in different ways, like the commonly used Consumer Price Index (CPI), the Fed prefers the PCE index because it better reflects changes in consumer spending patterns.

How quickly are prices rising?

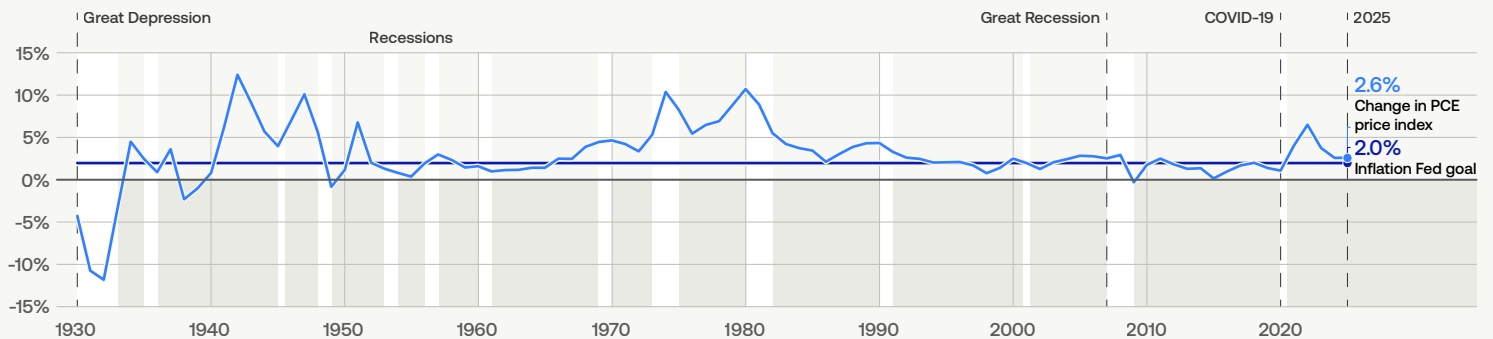
The year-over-year change in the PCE price index has been above the Fed's 2% goal since February 2021. As of January 2026, the rate was at 2.8%. Shorter-term inflation measures can fluctuate from month to month. However, looking at inflation over a longer period provides additional context: from 2000 to 2025, the average annual PCE price index increase was about 2.2%. Inflation has averaged higher over an even longer period, about 2.9% since 1930, largely driven by high inflation in the 70s and 80s.

Year-over-year percent change in monthly Personal Consumption Expenditures (PCE) price index



Source: Federal Reserve Bank of St. Louis

Percent change in annual average Personal Consumption Expenditures (PCE) price index



Source: Federal Reserve Bank of St. Louis

How have inflation trends evolved over time? Where do they stand today?

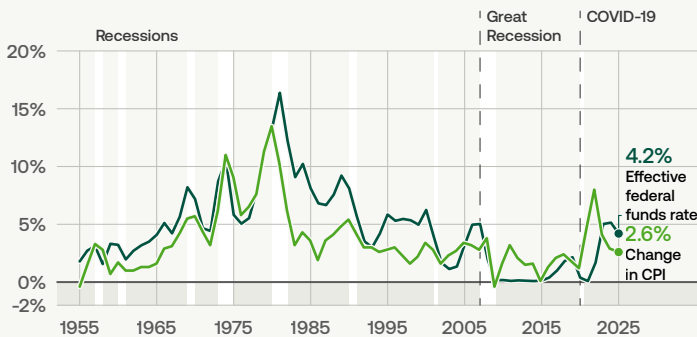
While the Federal Reserve defines its inflation objective using the PCE price index, the Consumer Price Index provides a longer historical view of inflation and is commonly used to describe changes in consumer prices over time.

Historically, inflation has varied in response to economic conditions. During the Great Recession (2007–2009), inflation cooled, and prices briefly declined. Conversely, during the COVID-19 pandemic, inflation reached a 40-year high. Over these periods, inflation and monetary policy moved together. The effective federal funds rate decreased during the Great Recession and was near zero in the years afterward. The Fed increased the rate during the post-pandemic period when inflation spiked.

The average monthly inflation rate in 2025 was 2.6%. It was slightly lower than the 2024 average rate of 2.9%, and lower than the 2019–2024 average rate of 3.8%. In February 2026, year-over-year inflation was 2.4%, unchanged from the month before.

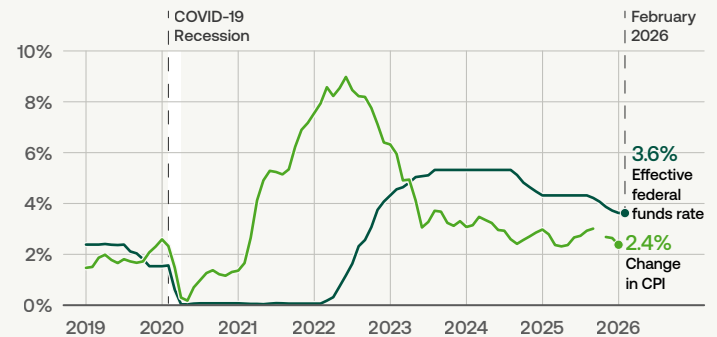
Because monetary policy affects borrowing costs, spending, and investment gradually, changes in economic activity — and ultimately inflation — often appear with a delay after policy adjustments. It is also important to note that many factors beyond interest rates, including supply chains, energy prices, and global economic conditions, also influence prices.

Annual percent change in Consumer Price Index (CPI) vs. annual effective federal funds rate



Source: Bureau of Labor Statistics and Federal Reserve Bank of St. Louis

Year-over year percent change in Consumer Price Index (CPI) vs. monthly effective federal funds rate



Source: Bureau of Labor Statistics and Federal Reserve Bank of St. Louis
Note: Consumer Price Index data is seasonally adjusted. Due to the 2025 government shutdown, the BLS did not publish October 2025 data.

Evaluating the dual mandate: Maximum employment

The Fed's second mandate, maximum employment, does not correspond to a single fixed number. Instead, it evaluates a range of labor market indicators to assess the employment picture. These indicators include unemployment, the employment-to-population ratio, labor force participation, job openings and hiring rates, wages and wage growth, and hours worked. Together, these capture worker supply and employer demand. Monetary policy affects these measures indirectly — and with a lag. Long-term factors such as population aging, educational trends, and caregiving responsibilities can also influence labor market outcomes independently of economic conditions.

What is the unemployment rate?

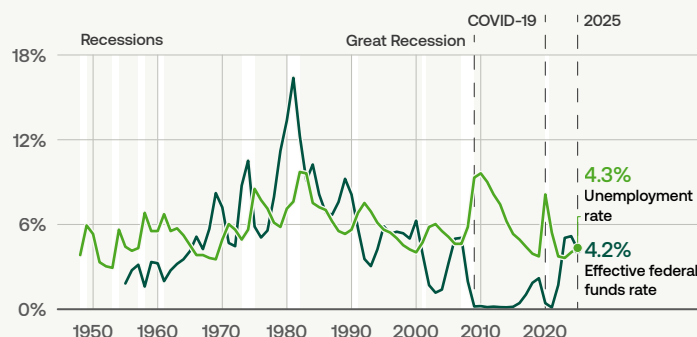
The unemployment rate measures the share of people in the labor force who are actively seeking work but not currently employed. It is one of the most cited labor market indicators. The public understands this well-known metric, making it useful for communicating the state of the economy. It's measured the same way over time and updated every month, allowing for consistent comparisons. Also, sharp changes in the unemployment rate have historically signaled economic downturns, making it a useful indicator when the economy begins to slow. The unemployment rate increased during each of the last 12 US recessions.

In 2025, the average annual unemployment rate was 4.3%, marking the second consecutive year of rising unemployment. Even so, this level remained below the long-term average (1948–2025) of 5.7%, which is also the 21st-century average.

As of February 2026, the unemployment rate was at 4.4%. This was 0.2 percentage points above February 2025, and 0.9 percentage points above the pre-pandemic level in February 2020.

Unemployment rate vs. effective federal funds rate

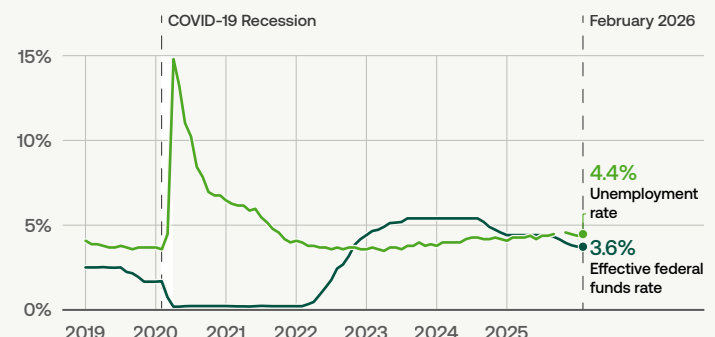
Annual average



Source: Bureau of Labor Statistics

Note: Annual data for the effective federal funds rate begins in 1955 because the Federal Reserve did not consistently publish the rate earlier.

Unemployment rate vs. monthly effective federal funds rate



Source: Bureau of Labor Statistics

Note: Unemployment rate data is seasonally adjusted. Due to the 2025 government shutdown, the BLS did not publish October 2025 data.

What is the employment-to-population ratio?

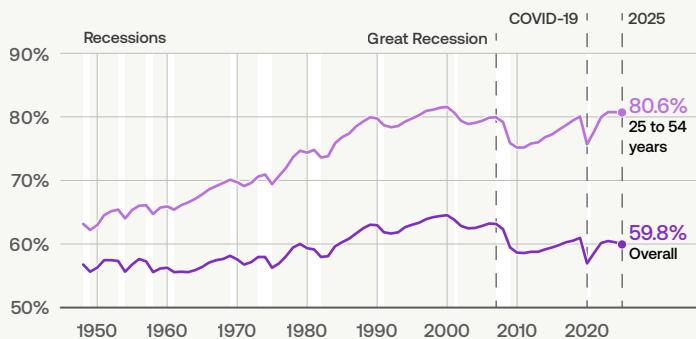
To better understand how the labor market is evolving, the Fed also considers the employment-to-population ratio. It is one of the broadest employment measures available. It shows the share of people who are employed, offering a direct view of how fully the economy is putting people to work. The prime-age version of this measure looks only at adults ages 25–54, making it less affected by the aging population and retirement trends and more reflective of current labor market conditions. Looking at both together helps distinguish between shifts driven by economic conditions and those driven by changes in the workforce's size and composition.

Both the overall employment-to-population ratio and the prime-age measure peaked in 2000, at 64.4% and 81.5%, respectively. In 2025, the prime-age ratio stood at 80.6%, about 1 percentage point below its historical peak. However, this marked the first decline in the prime-age ratio since 2020, while the overall employment-to-population ratio decreased for a second consecutive year. Historically, labor market conditions have weakened during economic downturns and strengthened during recoveries. Unemployment rose sharply during the Great Recession and again during the COVID-19 pandemic, followed by periods of sustained improvement.

In February 2026, the overall rate was 59.3% and the prime-age rate was 80.7%, both down from the month before. While the overall rate decreased compared to February 2025 (0.6 percentage points) and February 2020 (1.8 percentage points), the prime-age rate increased slightly by 0.2 and 0.3 percentage points, respectively.

Annual employment-to-population ratio

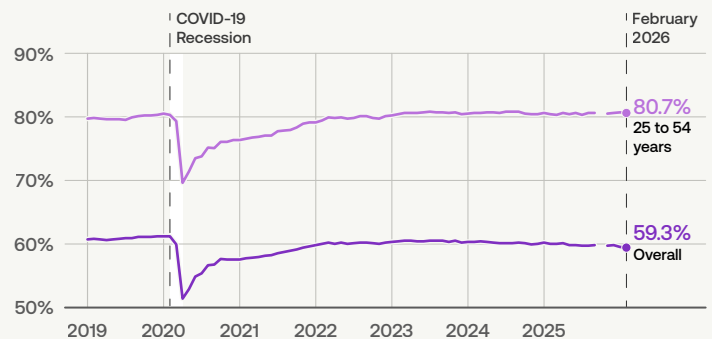
Overall and among 25–54 year olds



Source: Bureau of Labor Statistics and Federal Reserve Bank of St. Louis

Monthly employment-to-population ratio

Overall and among 25–54 year olds



Source: Federal Reserve Bank of St. Louis

Note: Data is seasonally adjusted. Due to the 2025 government shutdown, the BLS did not publish October 2025 data.

Chapter sources and data timeliness

Publishing agency	Program	Publication name	Data updates
Bureau of Labor Statistics	Consumer Price Index	CPI news release	Updates monthly for most recently completed month
	Current Population Survey	Employment Situation Summary	
Federal Reserve Bank of St. Louis	FRED Economic Data	Effective federal funds rate	Updates daily for most recently completed business day
		Federal funds target range - lower and upper limit	
		Market yield on US Treasury securities at 10-year constant maturity	
		Employment-population	Updates monthly for most recently completed month
		Personal consumption expenditures: Chain-type price index	
		Unemployment rate	
		Finance rate on 24-month personal loans at commercial banks	Updates quarterly for most recently completed quarter
		Finance rate on new 48-month auto loans at commercial banks	
		30-year fixed rate mortgage average in the US	Updated weekly for the most recently completed week
		Total assets (less eliminations from consolidation)	

See sources and notes section at the end of this report for detailed citation information.

Chapter sources and notes

For each **chapter**, all chart names are listed, and additional information is provided for each.

1. Chart sources and notes are structured as follows:

Chart title: Source(s)

Note(s):

2. Fiscal years (FY) are equivalent to the federal fiscal year, unless otherwise noted. The federal fiscal year begins on October 1 of the previous year and ends on September 30 of the following year. For example, FY 2025 began on October 1, 2024, and ended on September 30, 2025.
3. USAFacts compiles data for government revenue, spending, and debt from various government sources, including the Office of Management and Budget, the Bureau of Economic Analysis, and the Federal Reserve. The full citations are not included below; to see detailed descriptions and notes about our methodology for compiling this data, please visit: <https://usafacts.org/our-data/>.

Federal Reserve

Federal Reserve responsibilities: Federal Reserve System (2026) *The Fed Explained: What the Central Bank Does*. <https://www.federalreserve.gov/aboutthefed/files/the-fed-explained.pdf>.

Federal Reserve structure: Ibid.

Federal Reserve entities: Ibid.

The 12 Federal Reserve Banks: Federal Reserve Bank of Kansas City (2026) *Federal Reserve District County Shapefiles*. <https://www.kansascityfed.org/research/technical-briefings-sub/federal-reserve-district-county-shapefiles>.

Federal Open Market Committee intended chain of events: Ibid.

Federal funds target range: (1) Board of Governors of the Federal Reserve System (2026). *FRED* (Federal Funds Target Range - Lower Limit [DFEDTARL]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/DFEDTARL>; (2) Board of Governors of the Federal Reserve System (2026). *FRED* (Federal Funds Target Range - Upper Limit [DFEDTARU]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/DFEDTARU>.

Effective federal funds rate: Board of Governors of the Federal Reserve System (2026). *FRED* (Effective Federal Funds Rate [EFFR]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/EFFR>.

Commercial bank rate on new 48-month auto loans vs. monthly effective federal funds rate: (1) Board of Governors of the Federal Reserve System (2026). *FRED* (Finance Rate on Consumer Installment Loans at Commercial Banks, New Autos 48 Month Loan [TERMCBAUTO48NS]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/TERMCBAUTO48NS>; (2) Board of Governors of the Federal Reserve System (2026). *FRED* (Federal Funds Effective Rate [FEDFUNDS]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/FEDFUNDS>.

Commercial bank rate on new 24-month personal loans vs. monthly effective federal funds rate: (1) Board of Governors of the Federal Reserve System (2026). *FRED* (Finance Rate on Personal Loans at Commercial Banks, 24 Month Loan [TERMCBPER24NS]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/TERMCBPER24NS>; (2) Board of Governors of the Federal Reserve System (2026). *FRED* (Federal Funds Effective Rate [FEDFUNDS]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/FEDFUNDS>.

Yield on 10-year Treasury securities vs. 30-year mortgage rate, monthly average: (1) BEA (2026). *FRED* (Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis [DGS10]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/DGS10>; (2) BEA (2026). *FRED* (30-Year Fixed Rate mortgage Average in the United States [MORTGAGE30US]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/MORTGAGE30US>.

Federal Reserve total net assets: Board of Governors of the Federal Reserve System (2026). *FRED* (Assets: Total Assets: Total Assets (Less Eliminations from Consolidation): Wednesday Level [WALCL]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/WALCL>.

Year-over-year percent change in monthly Personal Consumption Expenditures (PCE) price index: BEA (2026). *FRED* (Personal Consumption Expenditures: Chain-type Price Index [PCEPI]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/PCEPI>.

Percent change in annual average Personal Consumption Expenditures (PCE) price index: Ibid.

Annual percent change in Consumer Price Index (CPI) vs. annual effective federal funds rate: (1) US Bureau of Labor Statistics (2025). *CPI for All Urban Consumers* (CPI-U) (All items in U.S. city average, all urban consumers, Not seasonally adjusted (CUUR0000SA0); More formatting options: "12-Month Percentage Change" view). <https://data.bls.gov/timeseries/CUUR0000SA0>; (2) Board of Governors of the Federal Reserve System (2026). *FRED* (Federal Funds Effective Rate [FEDFUNDS]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/FEDFUNDS>.

Year-over-year percent change in Consumer Price Index (CPI) vs. monthly effective federal funds rate: (1) BLS (2026). *CPI for All Urban Consumers* (CPI-U) (All items in U.S. city average, all urban consumers, Seasonally adjusted (CUSR0000SA0); More formatting options: "12-Month Percentage Change" view). <https://data.bls.gov/timeseries/CUSR0000SA0>; (2) Board of Governors of the Federal Reserve System (2026). *FRED* (Federal Funds Effective Rate [FEDFUNDS]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/FEDFUNDS>.

Unemployment rate vs. effective federal funds rate: (1) BLS (2026). *FRED* (Unemployment rate [UNRATENSA]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/UNRATENSA>; (2) Board of Governors of the Federal Reserve System (2026). *FRED* (Federal Funds Effective Rate [FEDFUNDS]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/FEDFUNDS>.

Monthly unemployment rate vs. monthly effective federal funds rate: (1) BLS (2026). *FRED* (Unemployment rate [UNRATE]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/UNRATE>; (2) Board of Governors of the Federal Reserve System (2026). *FRED* (Federal Funds Effective Rate [FEDFUNDS]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/FEDFUNDS>.

Annual employment-to-population ratio: (1) BLS (2026). *FRED* (Employment-Population Ratio [LNU02300000]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/LNU02300000>; (2) BLS (2026). *Labor Force Statistics from the Current Population Survey* (Age 25 to 54, Employment-population ratio, Not seasonally adjusted (LNU02300060); More formatting options: "12-Month Percentage Change" view). <https://data.bls.gov/timeseries/LNU02300060>.

Monthly employment-to-population ratio: (1) BLS (2026). *FRED* (Employment-Population Ratio [EMRATIO]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/EMRATIO>; (2) BLS (2026). *FRED* (Employment-Population Ratio - 25-54 Yrs. [LNS12300060]). Federal Reserve Bank of St. Louis. <https://fred.stlouisfed.org/series/LNS12300060>