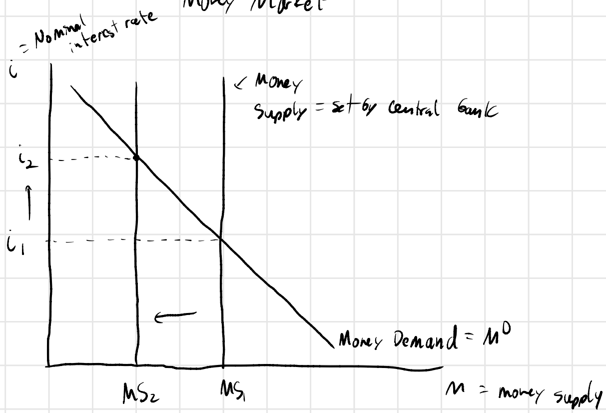
April 3: FOMC & Federal Reserve

Financial Assets, collapsed	
Money	Bonds
- immediately available - can be used to buy goods and services	- interest

Nominal interest rate = opportunity cost of money (what you give up holding money instead of bonds)

Money Market



How central bankers change money supply:

1) Open Market Operations:

- Sell bonds: take money out of circulation

- buy bonds: putting money into circulation

Buy bonds → Demand for bonds ↑

→ price of bonds ↑

→ interest rate ↓

Discount bond:

$P_0 = \$900 \qquad P_1 = \$1000$

$$i_1 = \frac{1000}{900} = (1.11) - 1 = 11.1\%$$

$P_2 = 950 \qquad P_1 = \$1000$

$$i_2 = \frac{1000}{950} - 1 = 5.26\%$$

2) Interest rates floor and ceiling

- Interest rate on reserves
- Discount rate

Interest rate on reserves ↓ → reserves ↓

→ loans ↑

→ M ↑

Federal Funds rate:

- excess reserves → lent to other banks
- overnight loan rate = FFR

IRR:

- sets floor on FFR
- No bank lends to another bank below IRR

Discount rate:

- rate on loans from discount window
- ceiling on FFR

FFR and market interest rates tend to move in tandem