



D_0 (from banks short of reserves)

Federal Funds





S_0 (from banks
with excess
reserves)

























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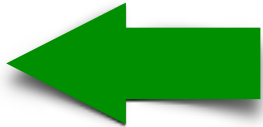
The effect of a decrease in GDP on the Federal Funds
Rate



The public **deposits** a **smaller**
portion of their income in
checking accounts



Deposits decrease



A leftward shift in
the Demand of
funds

$\text{ffr}_e = 3\%$



$Q^s = Q^d$

Assume the
market starts at
equilibrium





D_1 (from banks short of reserves)

$\text{ffr}_1 = 2\%$ — — — — — — — — — — ●

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$$Q^s = Q^d$$



The Fed Funds
Rate decrease

When GDP decrease,
consumers buy less: The public
need less liquid balances for
fewer transactions



Required Reserves
decrease

Demand for funds
decrease



Fewer banks will end the
day short of reserves

Federal Funds Rate

ffr

The effect of a decrease in GDP on the Federal Funds Rate

When GDP decrease, consumers buy less: The public need less liquid balances for fewer transactions



The public deposits a smaller portion of their income in checking accounts



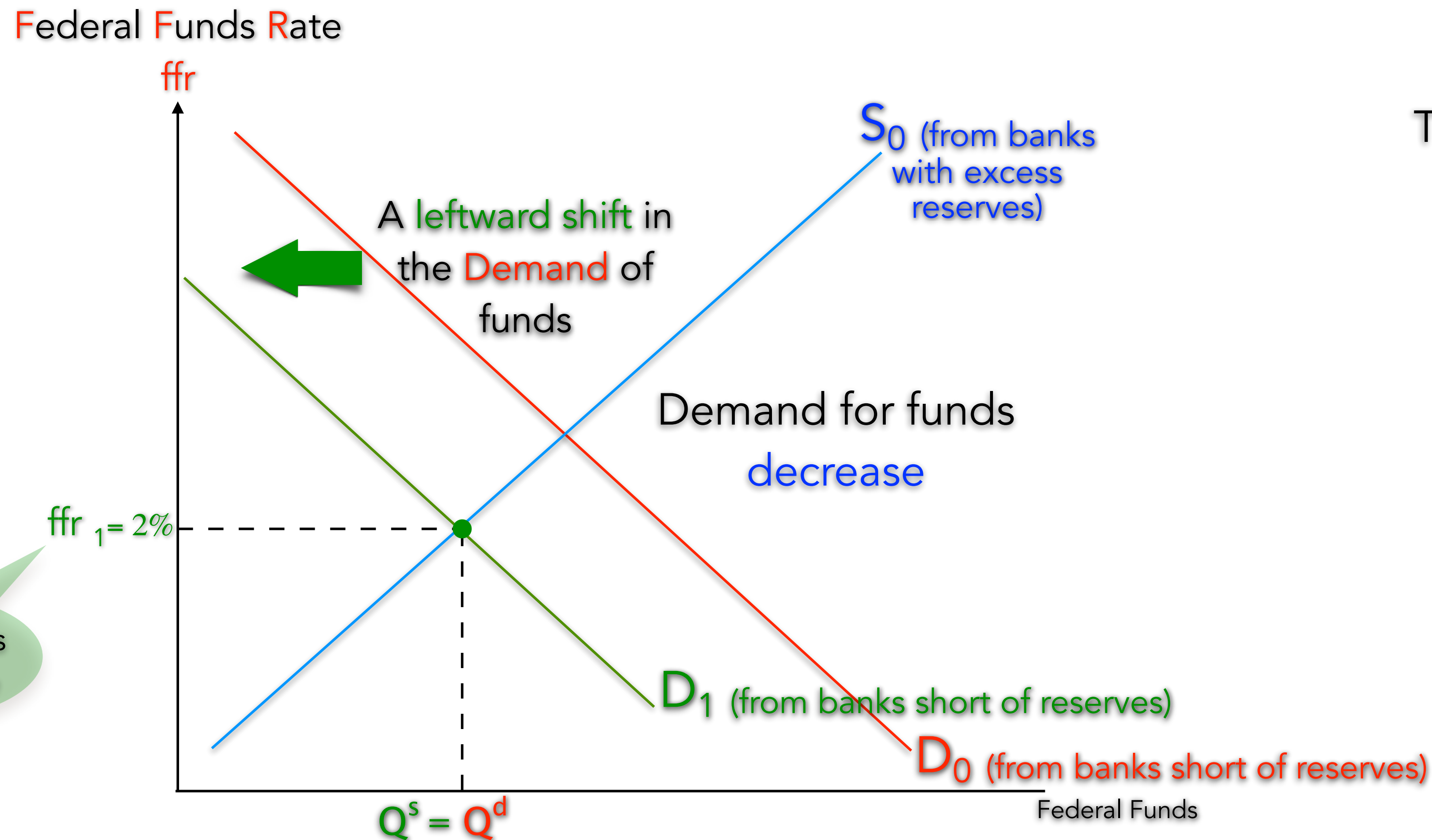
Deposits decrease



Required Reserves decrease



Fewer banks will end the day short of reserves



The Bond Market