





$D_0$  (from banks short of reserves)

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Federal Funds





$S_0$  (from banks  
with excess  
reserves)































**R**







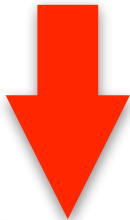








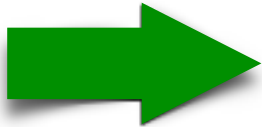
The effect of an increase in **Prices** on the Federal  
Funds Rate



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



Deposits increase



A rightward 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)



$\text{ffr}_1 = 4\%$

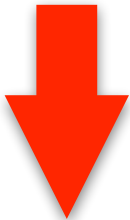


$Q^s = Q^d$



The Fed Funds  
Rate increase

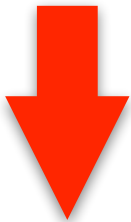
When **prices** increase, the  
public need **more** liquid  
balances to pay for more  
expensive transactions



Required Reserves  
increase

Demand for funds

increase



More banks will end the  
day short of reserves

Federal Funds Rate

ffr

# The effect of an increase in **Prices** on the Federal Funds Rate

When **prices** increase, the public need **more** liquid balances to pay for more expensive transactions



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



**Deposits increase**



**Required Reserves increase**



**More** banks will end the day **short** of reserves

