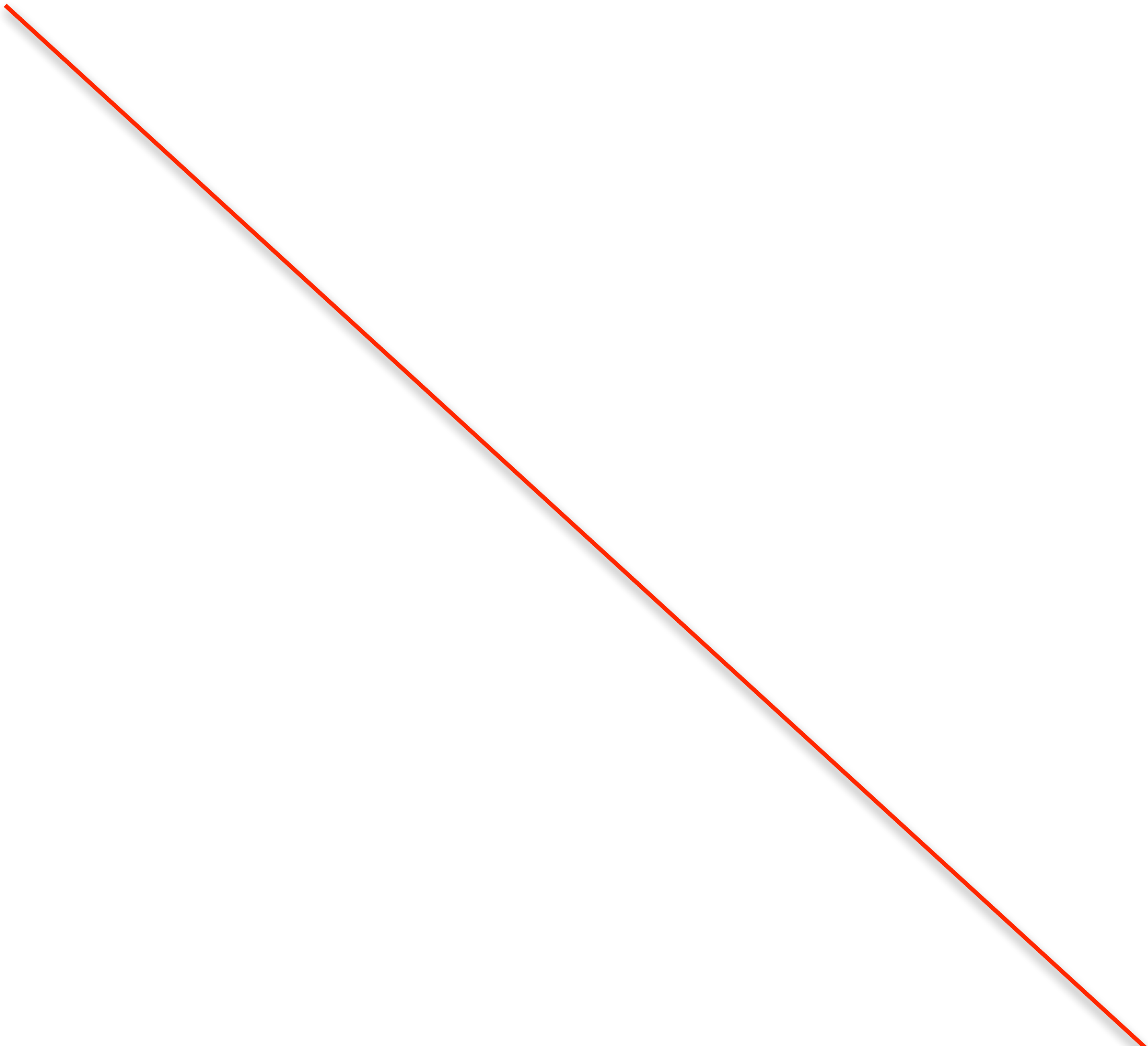
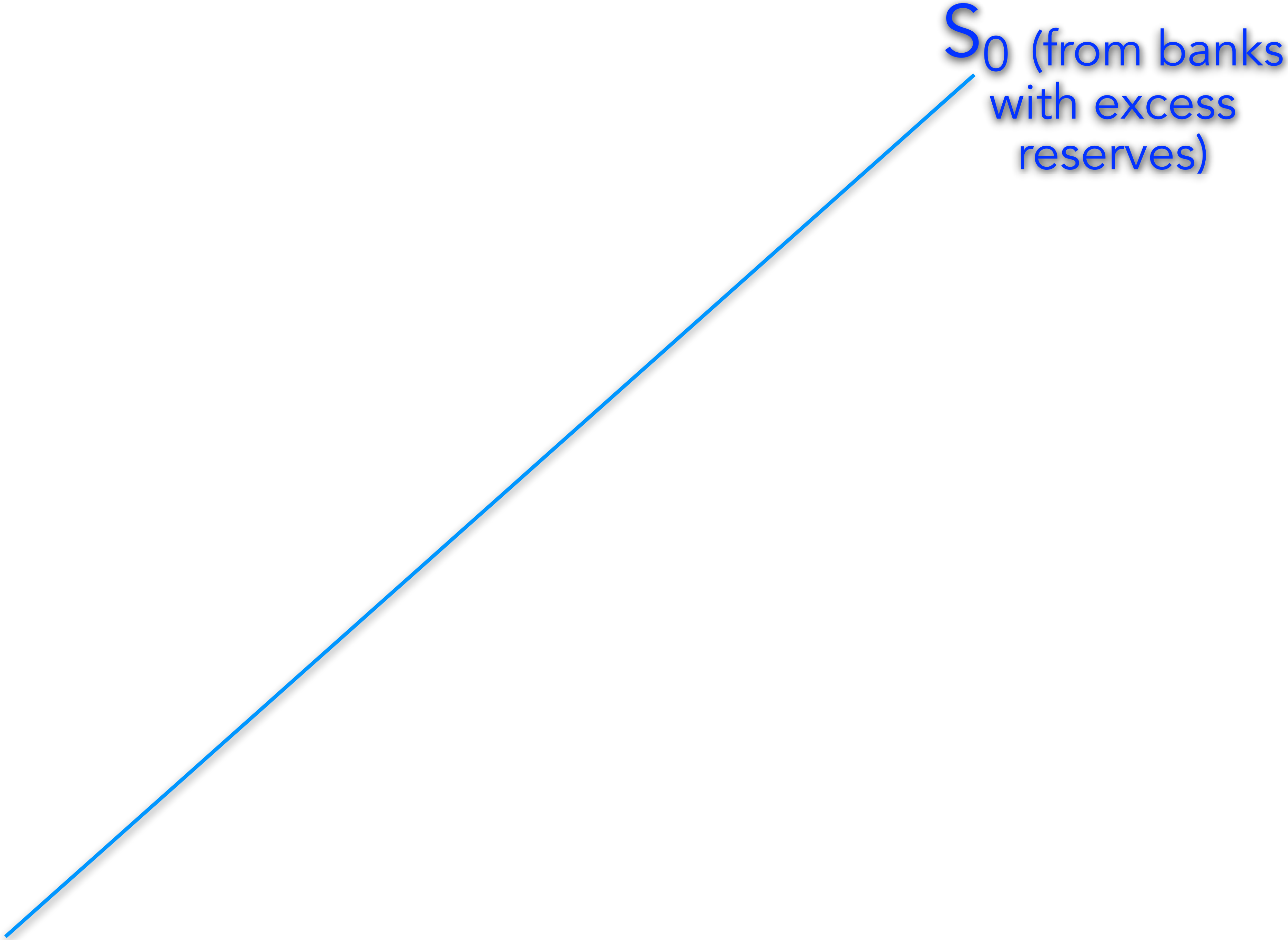


D_0 (from banks short of reserves)


S_0 (from banks
with excess
reserves)

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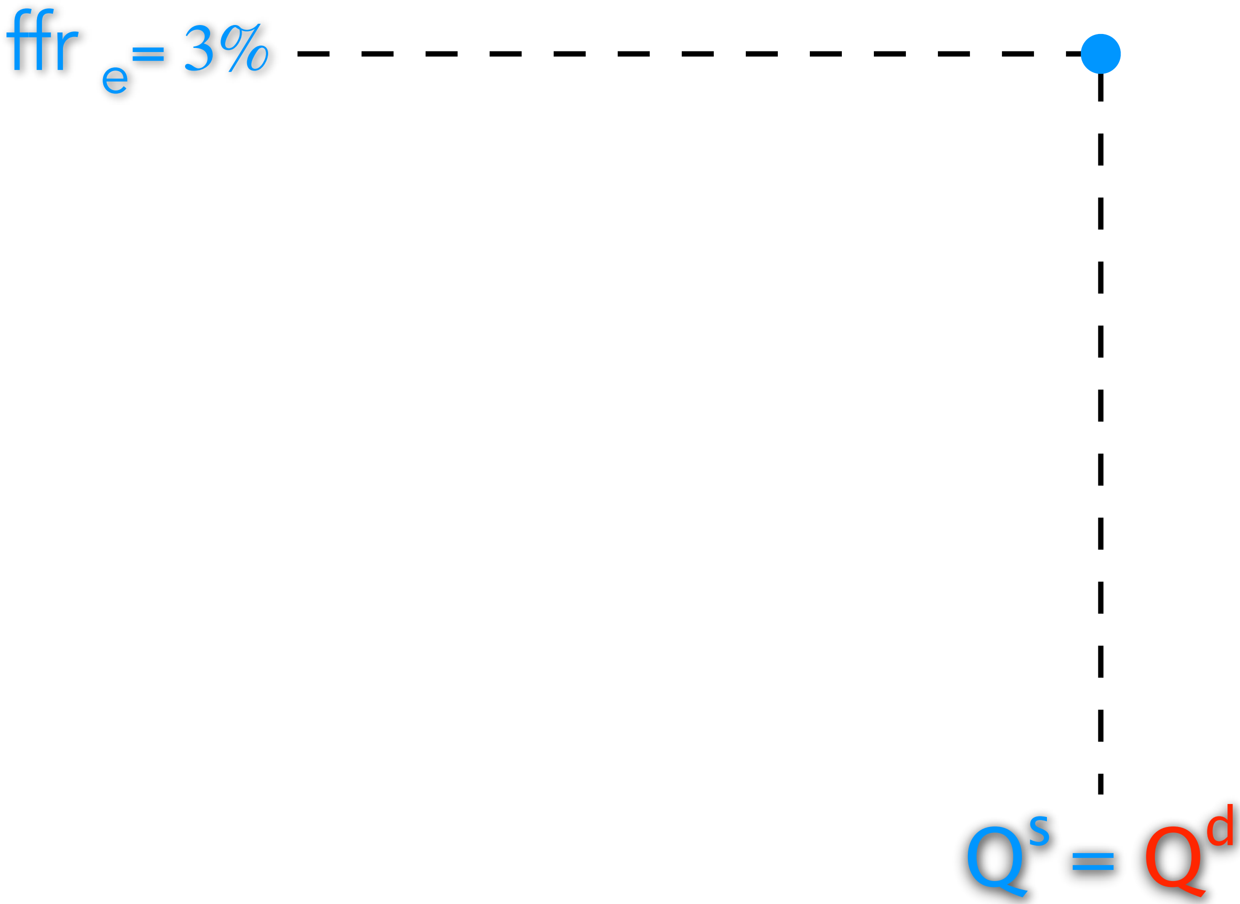
The effect of an increase in Prices on the Federal Funds Rate

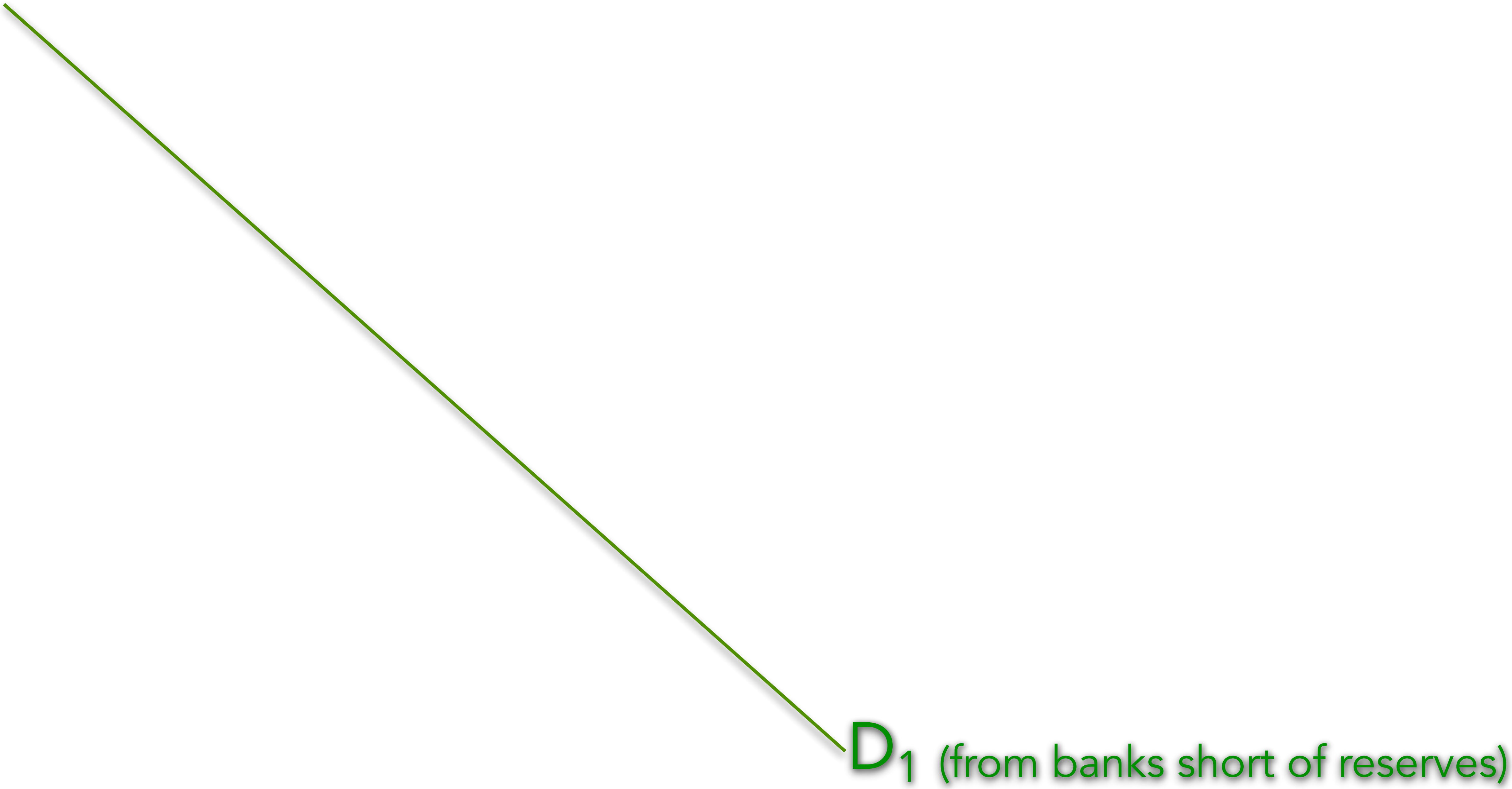
The public deposits a larger portion of their income in checking accounts

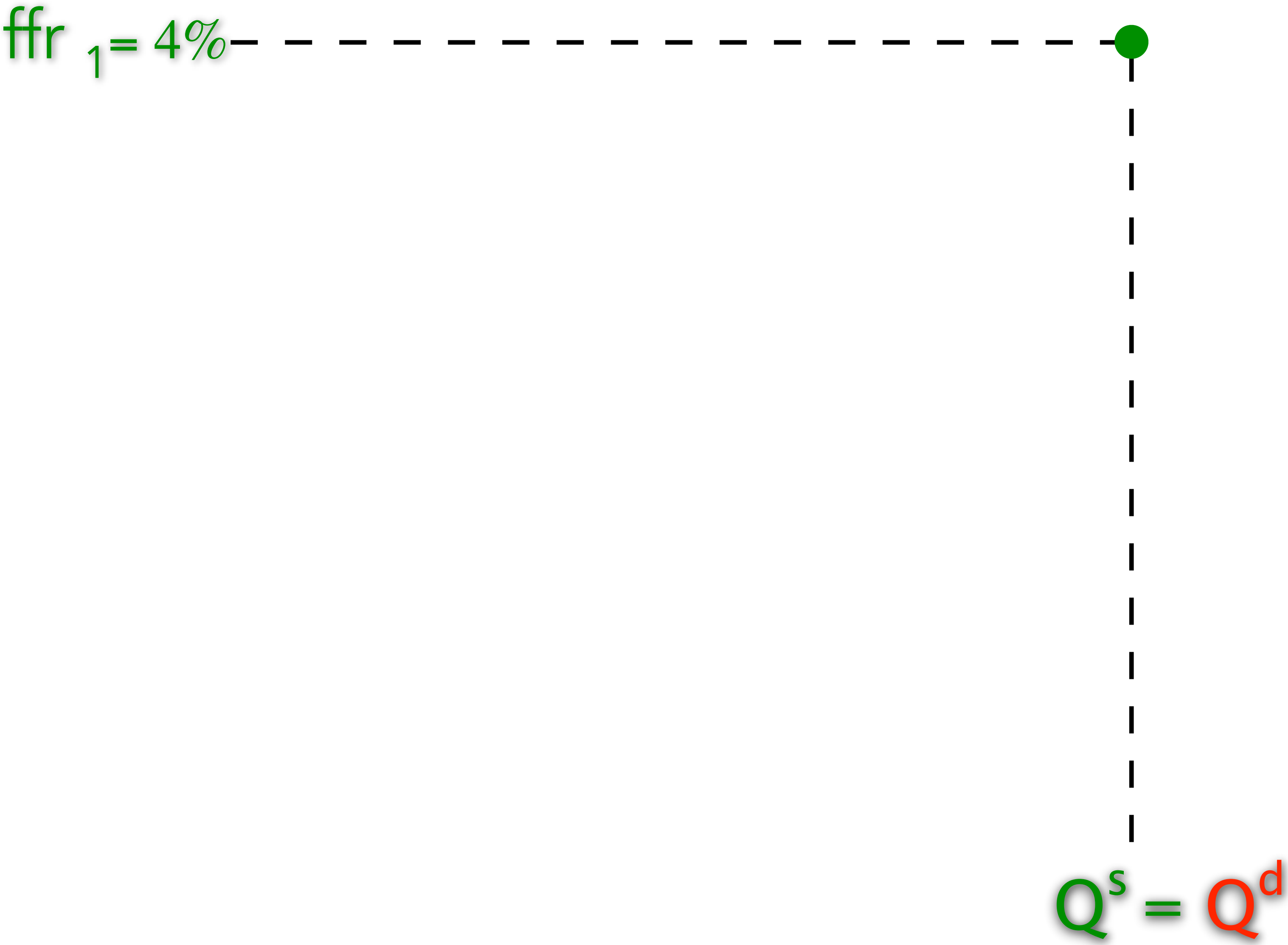
Deposits increase

A rightward shift in the Demand of funds


$ffr_e = 3\%$
$Q^s = Q^d$

Assume the market starts at equilibrium


D_1 (from banks short of reserves)


$ffr_1 = 4\%$
$Q^s = Q^d$

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

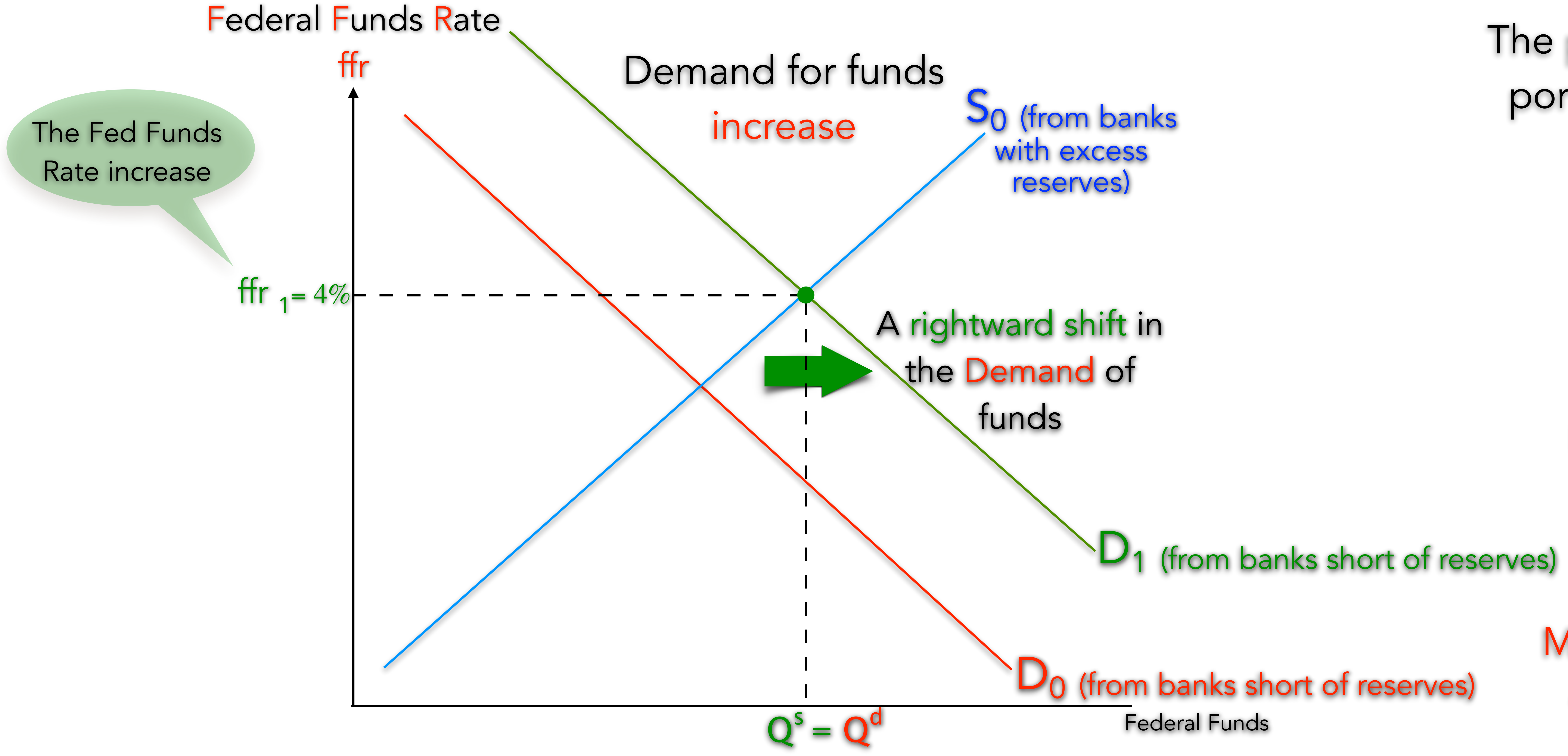
increase

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