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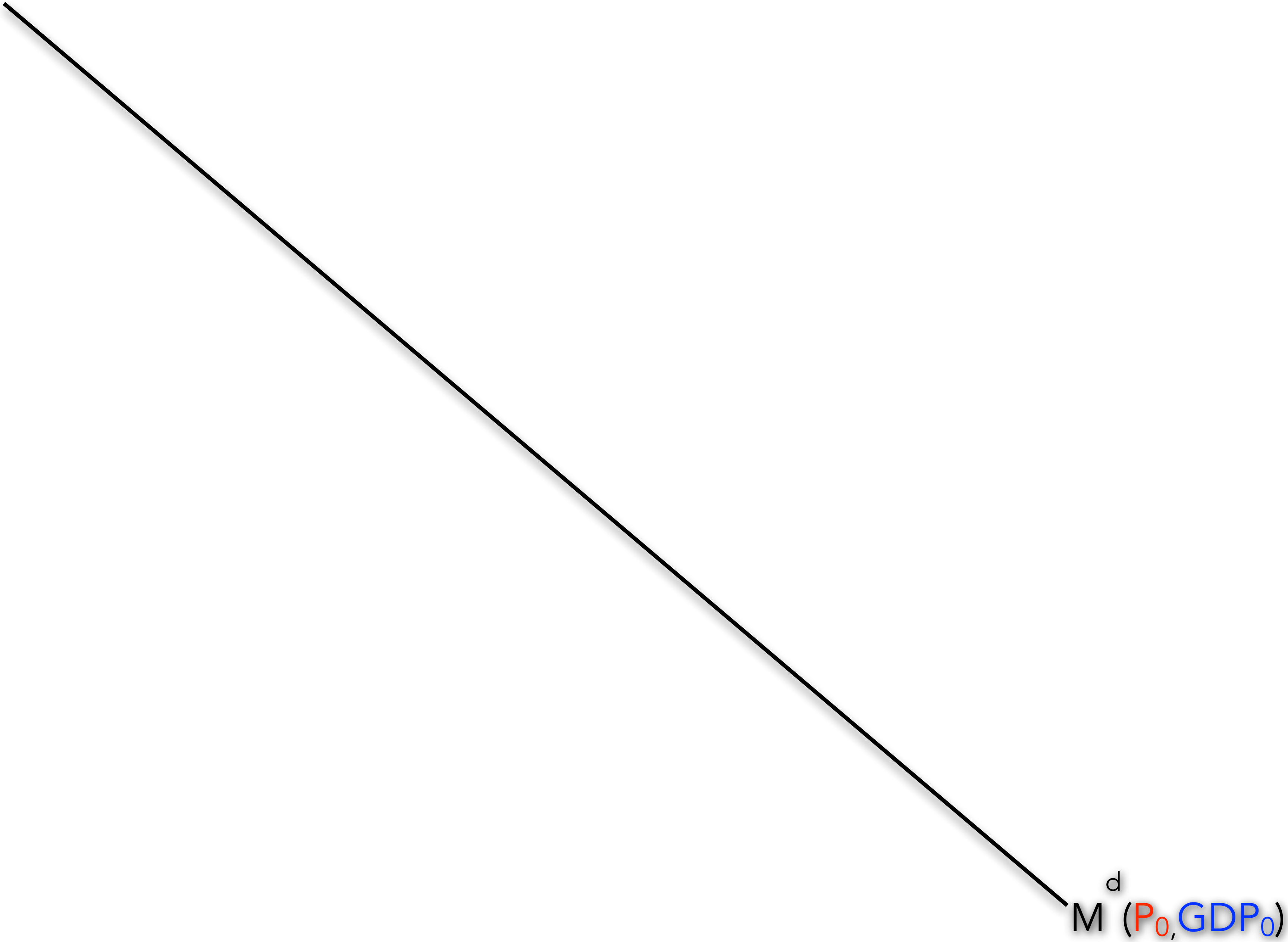
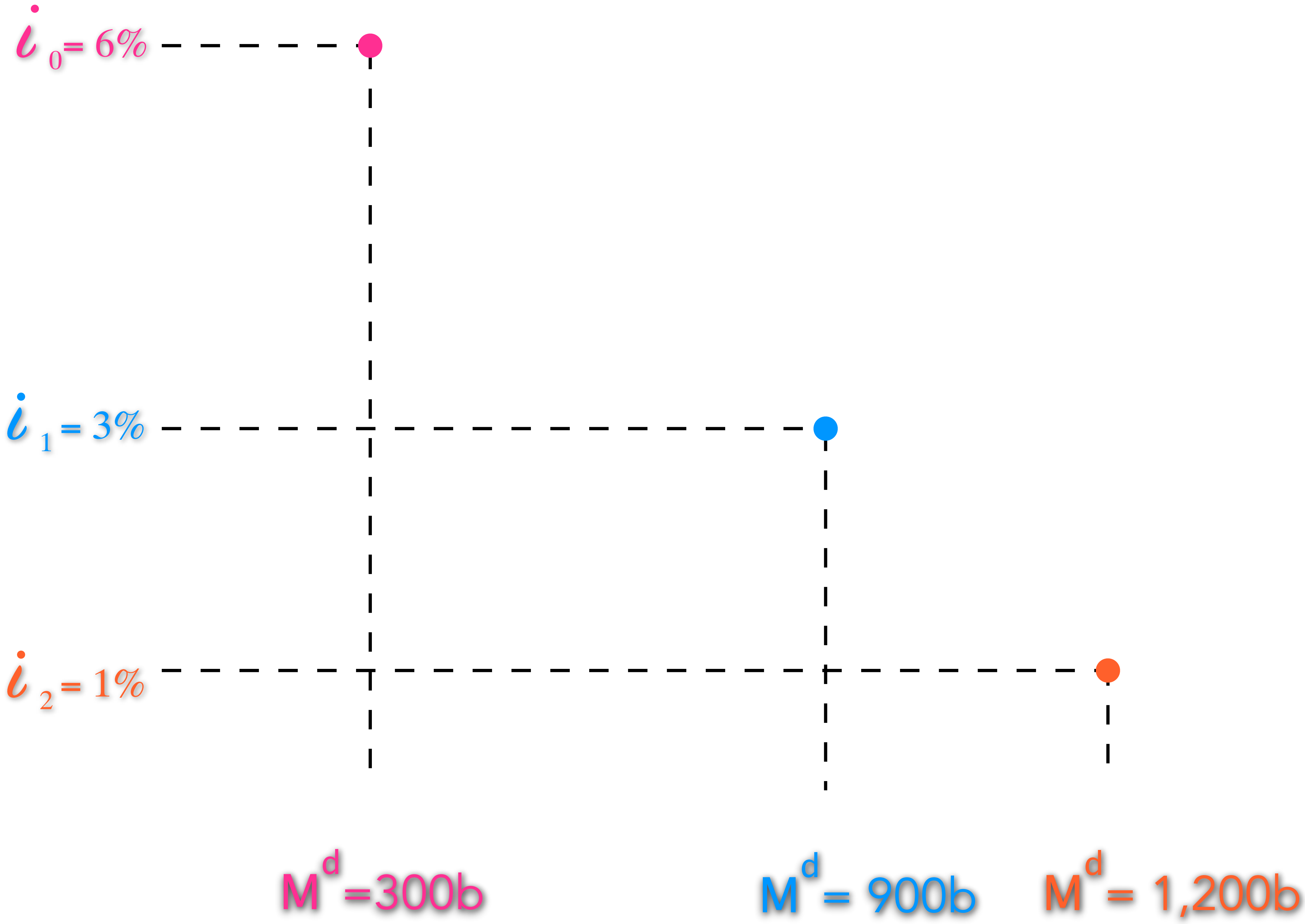
Currency+
Deposits

i


$M^d (P_0, GDP_0)$

M_0^s

$M_0^s = 900b$



$i_0 = 6\%$
$i_1 = 3\%$
$i_2 = 1\%$
$M^d = 300b$
$M^d = 900b$
$M^d = 1,200b$

Assume the Money Market starts at equilibrium

Fed sells Bonds:

M^s shifts left

Reserves

Loans

Deposits

$M^s \downarrow$

M_1^s

$M^s = 300b$

Short of liquid balances

When there are shortages of liquid balances, money is scarce and there is pressure for the interest rate to rise

The interest rate will rise to a new equilibrium at 6%

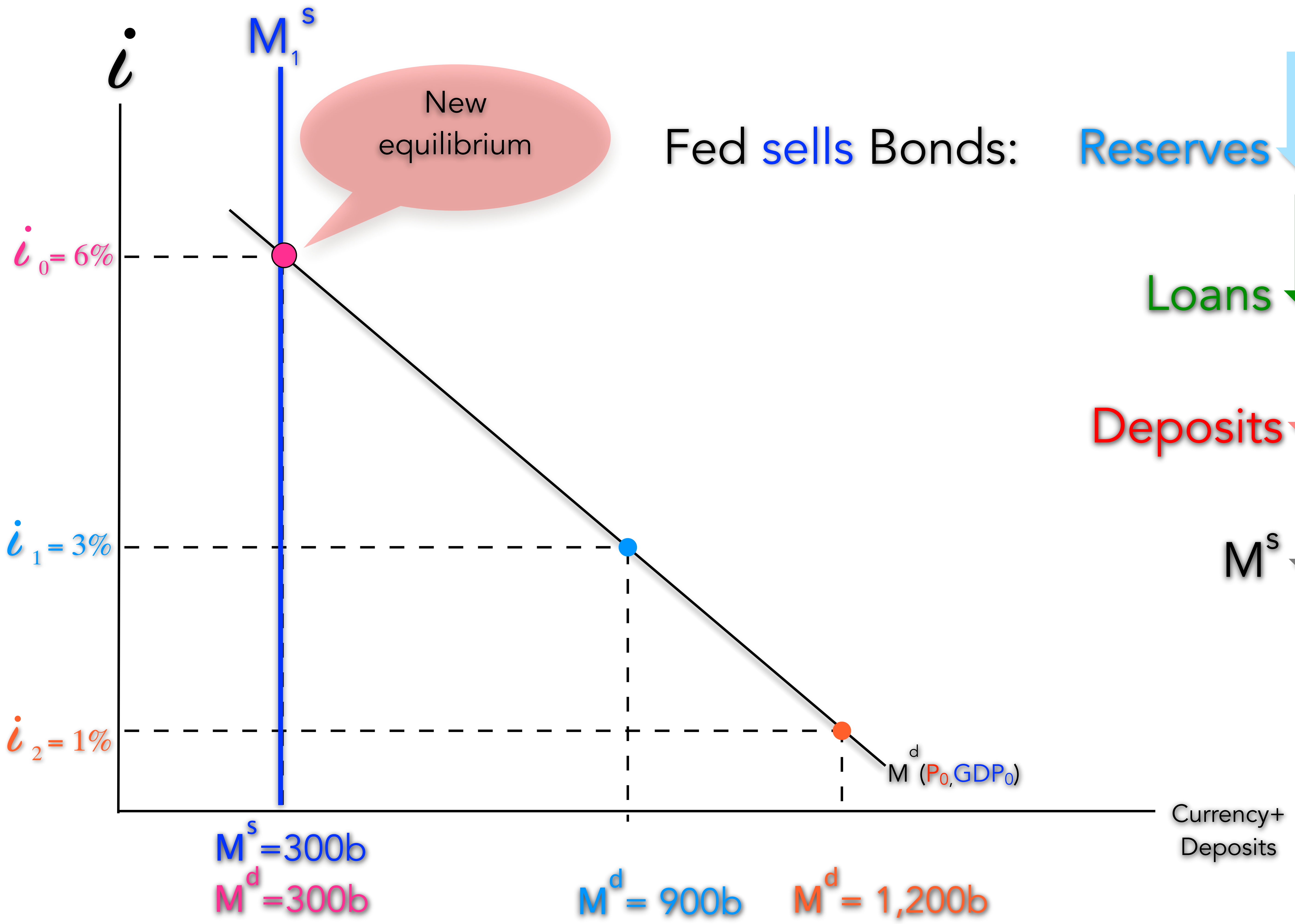

New
equilibrium

The Fed disappears reserves making money scarce

The effect of a sale of bonds by the Fed

The effect of a sale of bonds by the Fed

The interest rate will rise to a new equilibrium at 6%



Fed sells Bonds: Reserves ↓

Loans ↓

Deposits ↓

M^s ↓