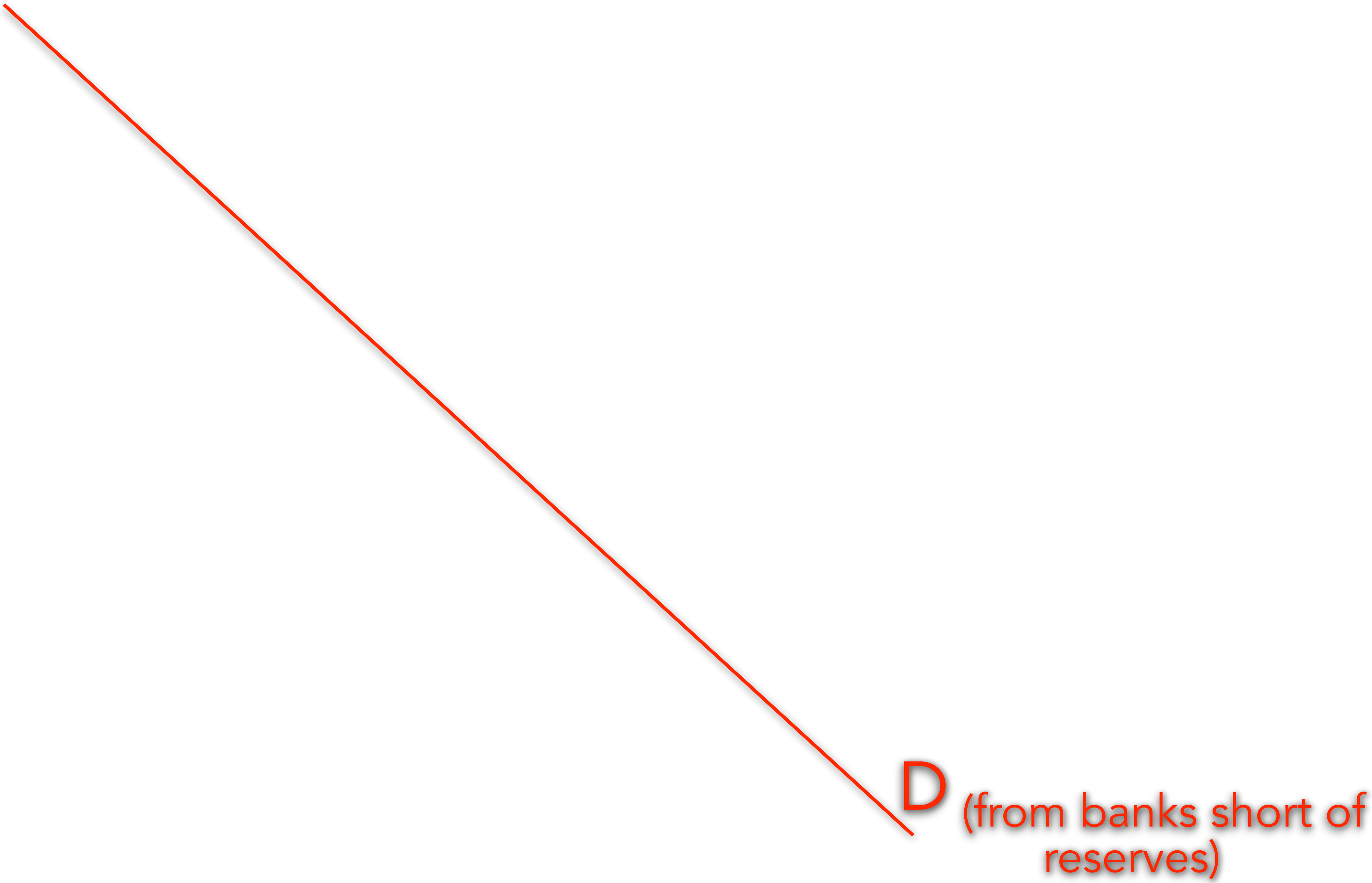
D
(from banks short of reserves)

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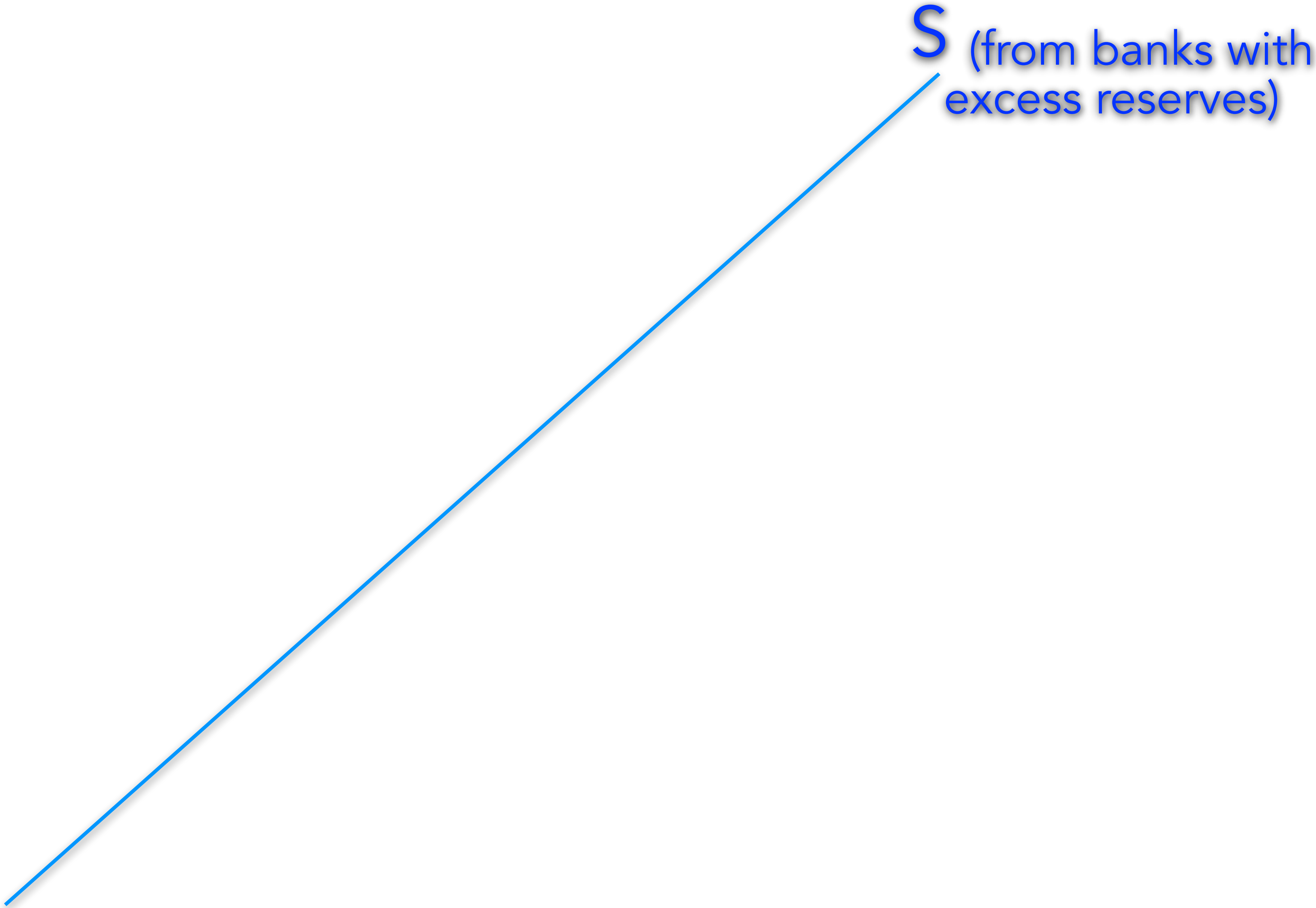
S (from banks with
excess reserves)

The Federal Funds Market

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Banks with excess reserves lend these reserves to banks short of reserves

These loans are made by banks to banks (the public is not involved), must be made right away and are made for a short period of time: overnight

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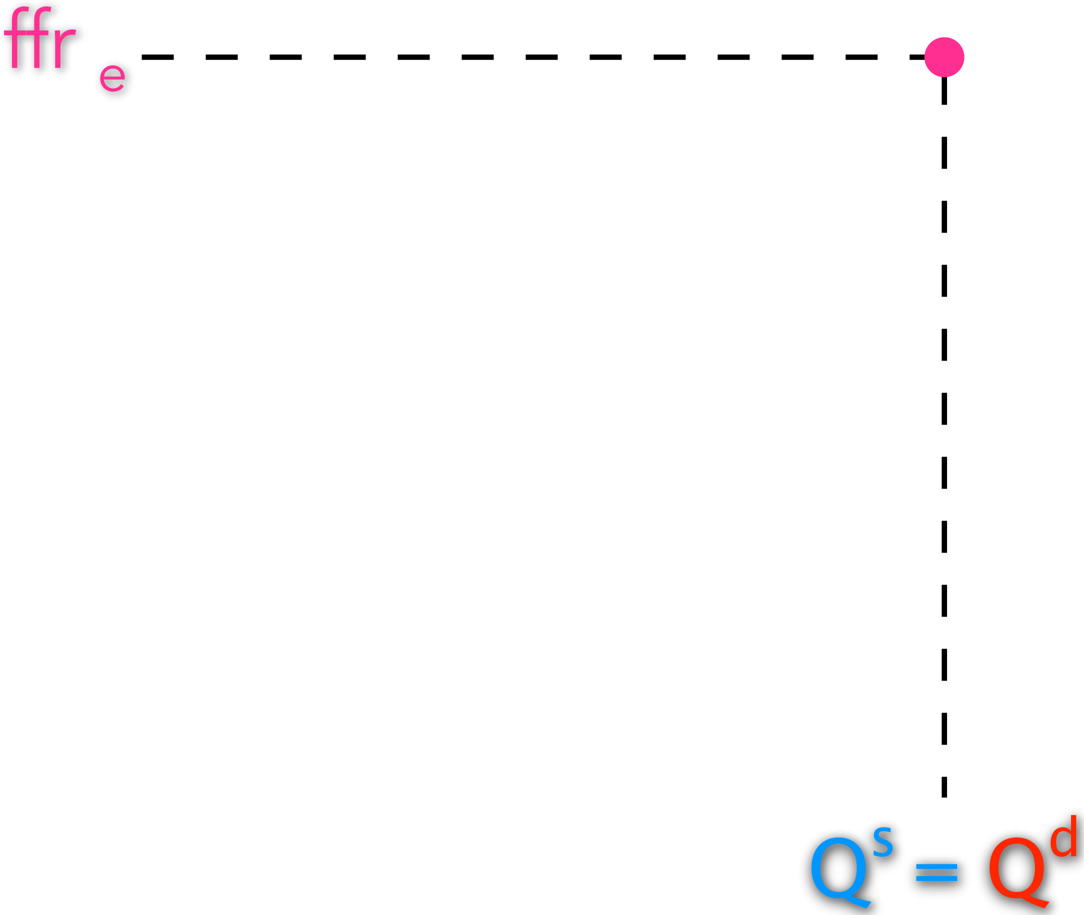
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Eventually this market settles at an equilibrium interest rate

At the end of business day, banks must have the required amount of reserves $R = r*D$

The interest rate on these loans is an interbank overnight rate

Federal Funds Rate

ffr

This interbank rate is determined by supply and demand:

- Banks lend to the bank(s) which offer the highest rate

- Banks borrow from the bank(s) which offer the lowest rate

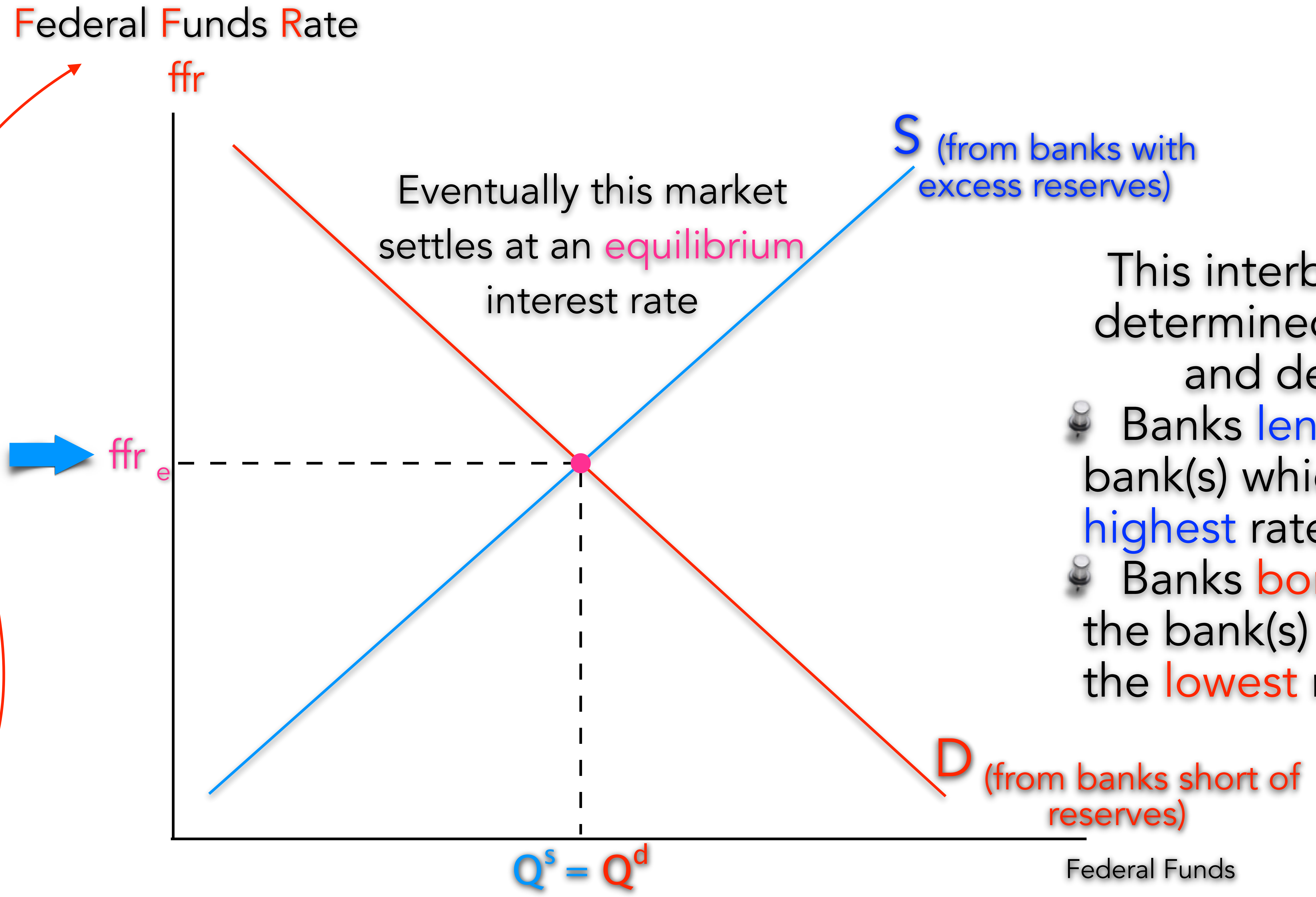
The Federal Funds Market

At the end of business day, banks must have the required amount of reserves $R = r*D$

Banks with excess reserves lend these reserves to banks short of reserves

These loans are made by banks to banks (the public is not involved), must be made right away and are made for a short period of time: overnight

The interest rate on these loans is an interbank overnight rate



This interbank rate is determined by supply and demand:

- Banks lend to the bank(s) which offer the highest rate
- Banks borrow from the bank(s) which offer the lowest rate