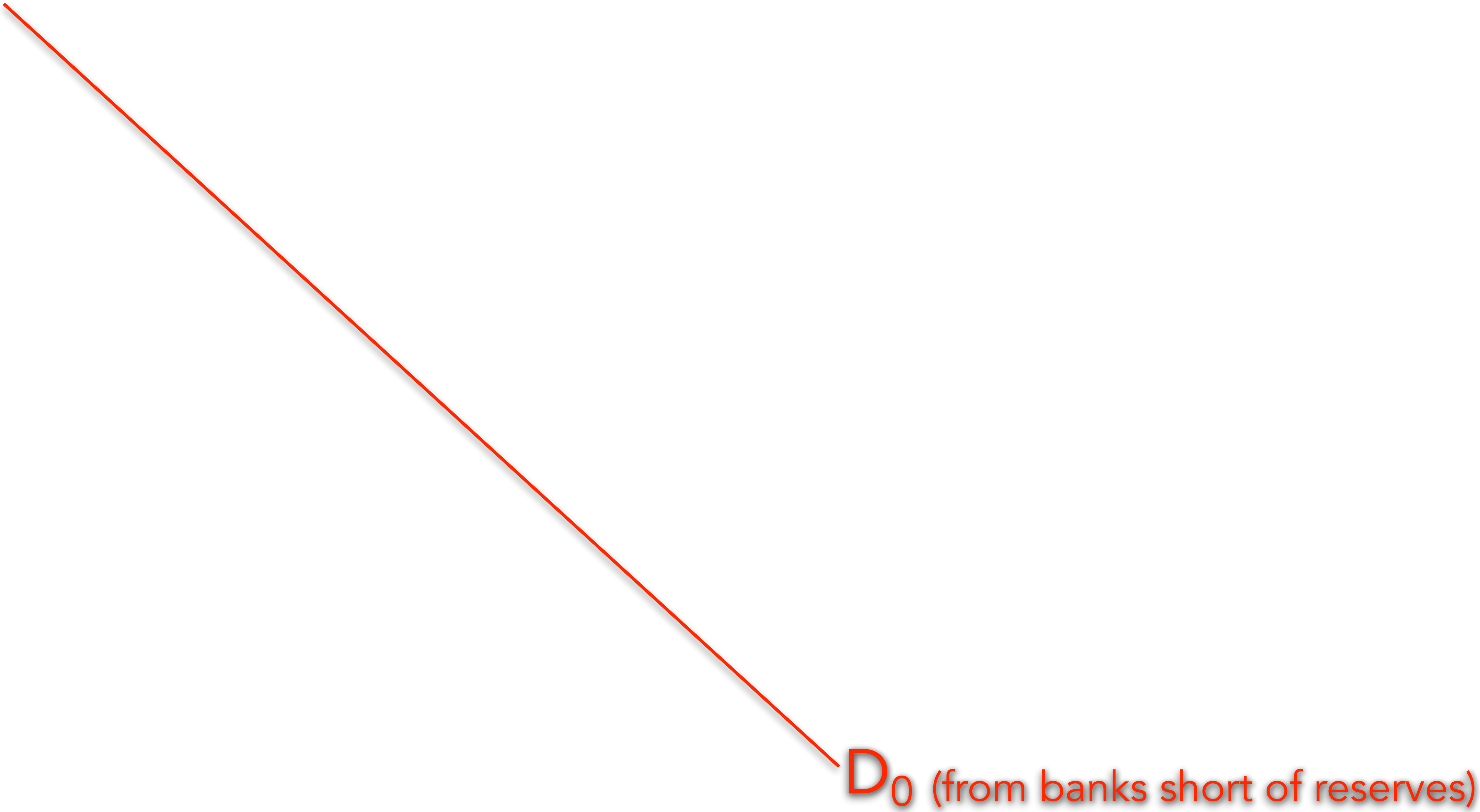
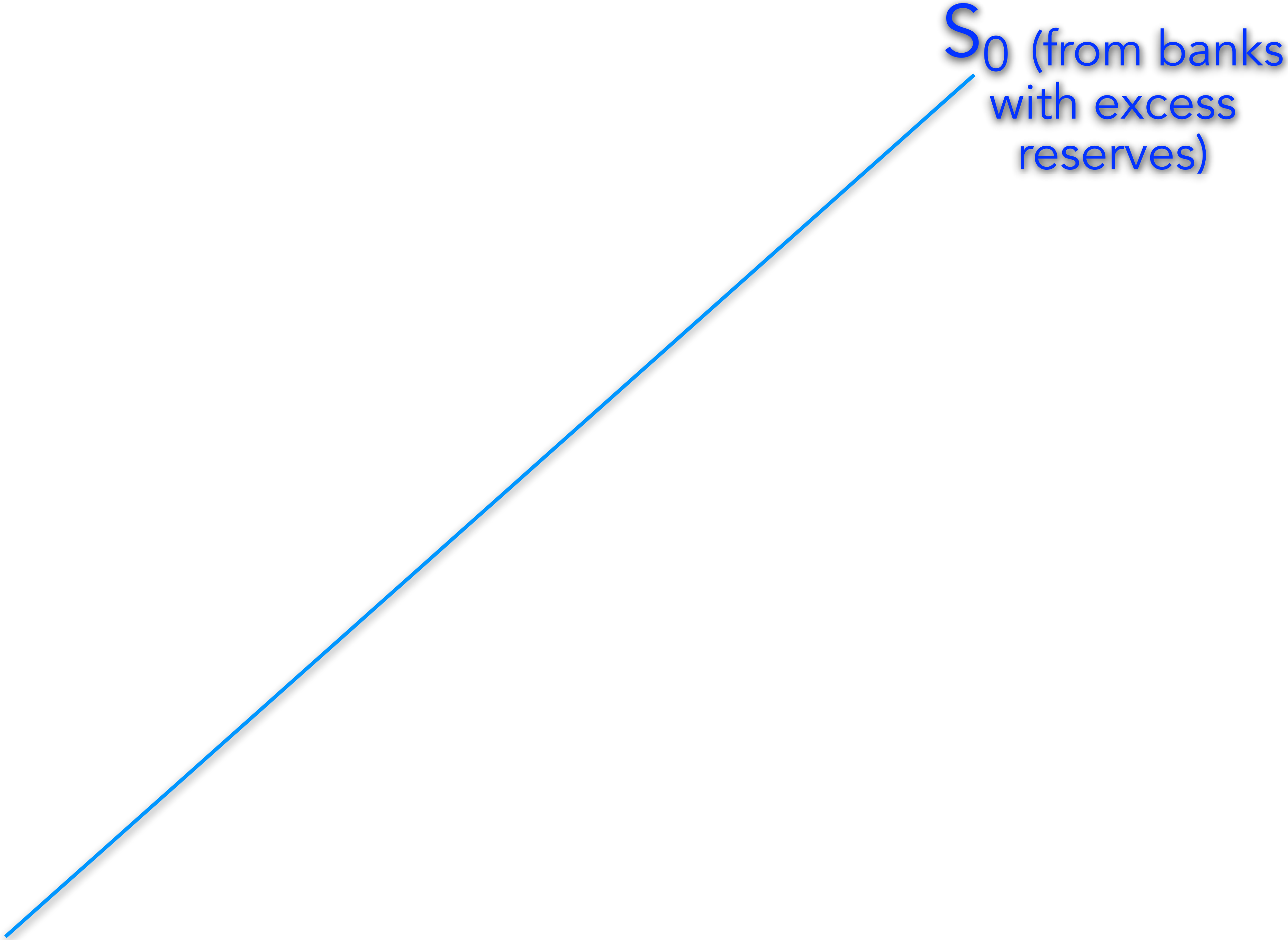

D0 (from banks short of reserves)

Federal Funds


S_0 (from banks
with excess
reserves)

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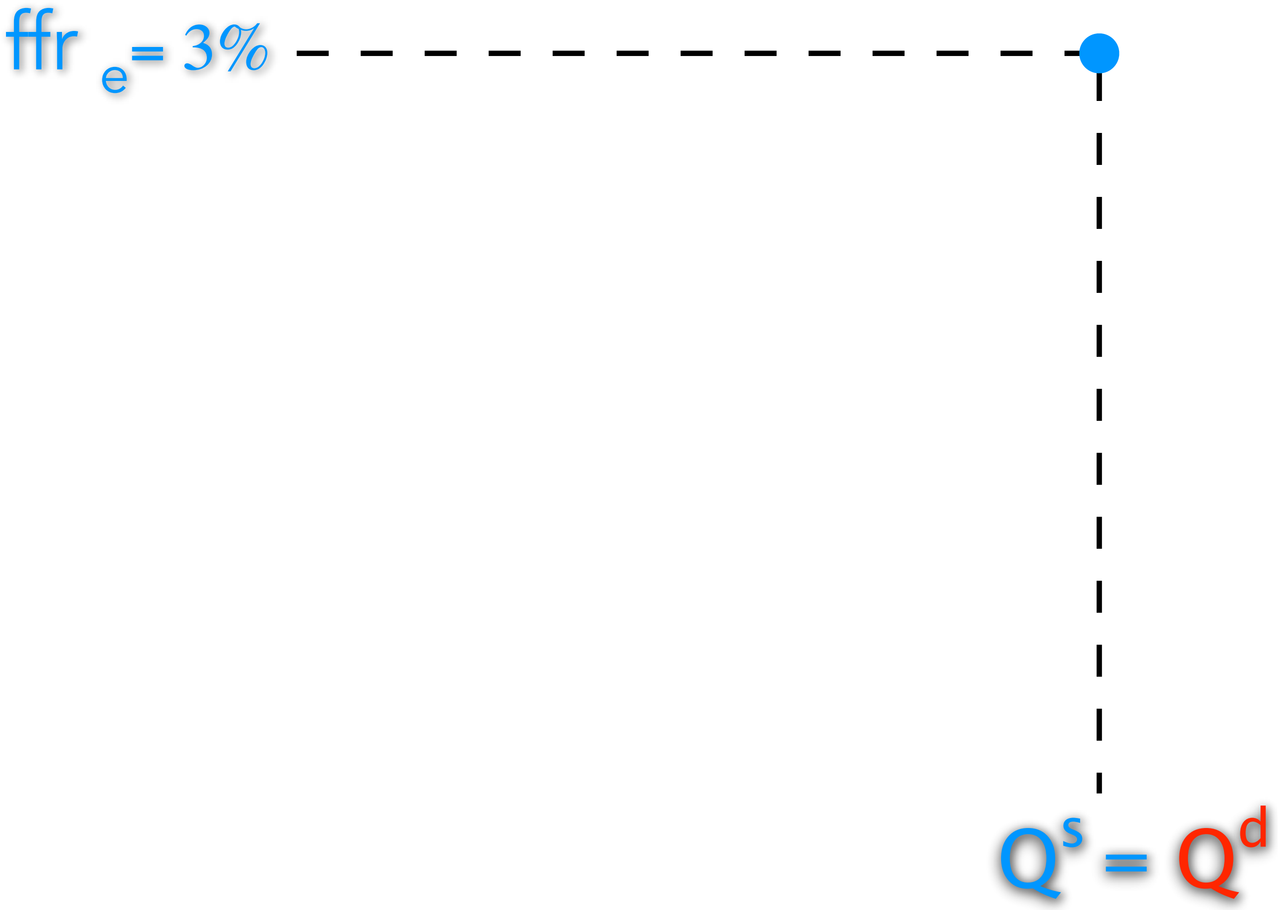
The effect of a decrease in GDP on the Federal Funds Rate

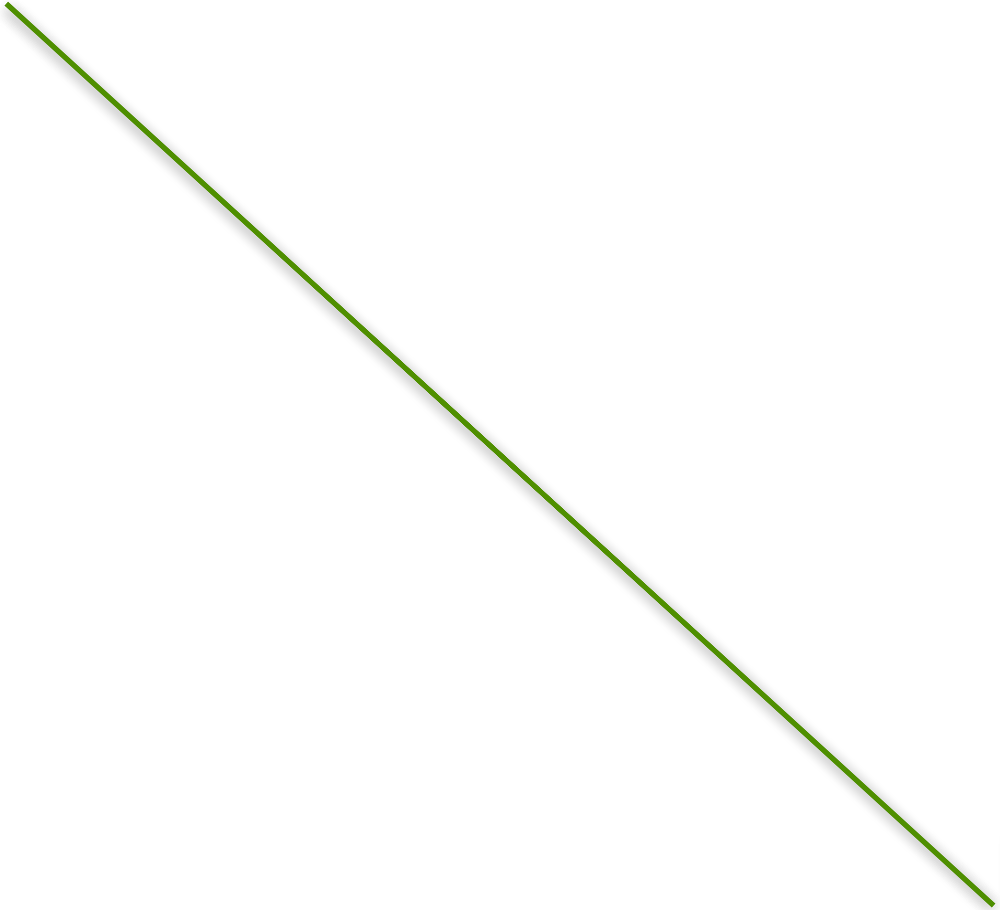
The public deposits a smaller portion of their income in checking accounts

Deposits decrease

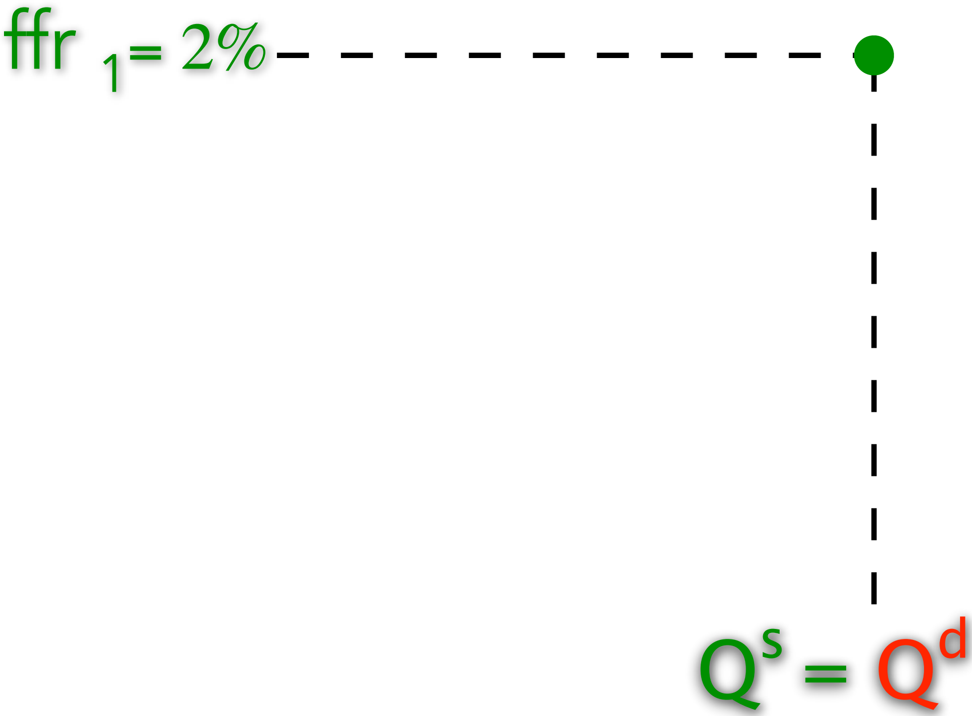
A leftward shift in the Demand of funds


ffr e= 3%
Qs = Qd

Assume the market starts at equilibrium



D_1 (from banks short of reserves)


ffr 1= 2%
Qs = Qd

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

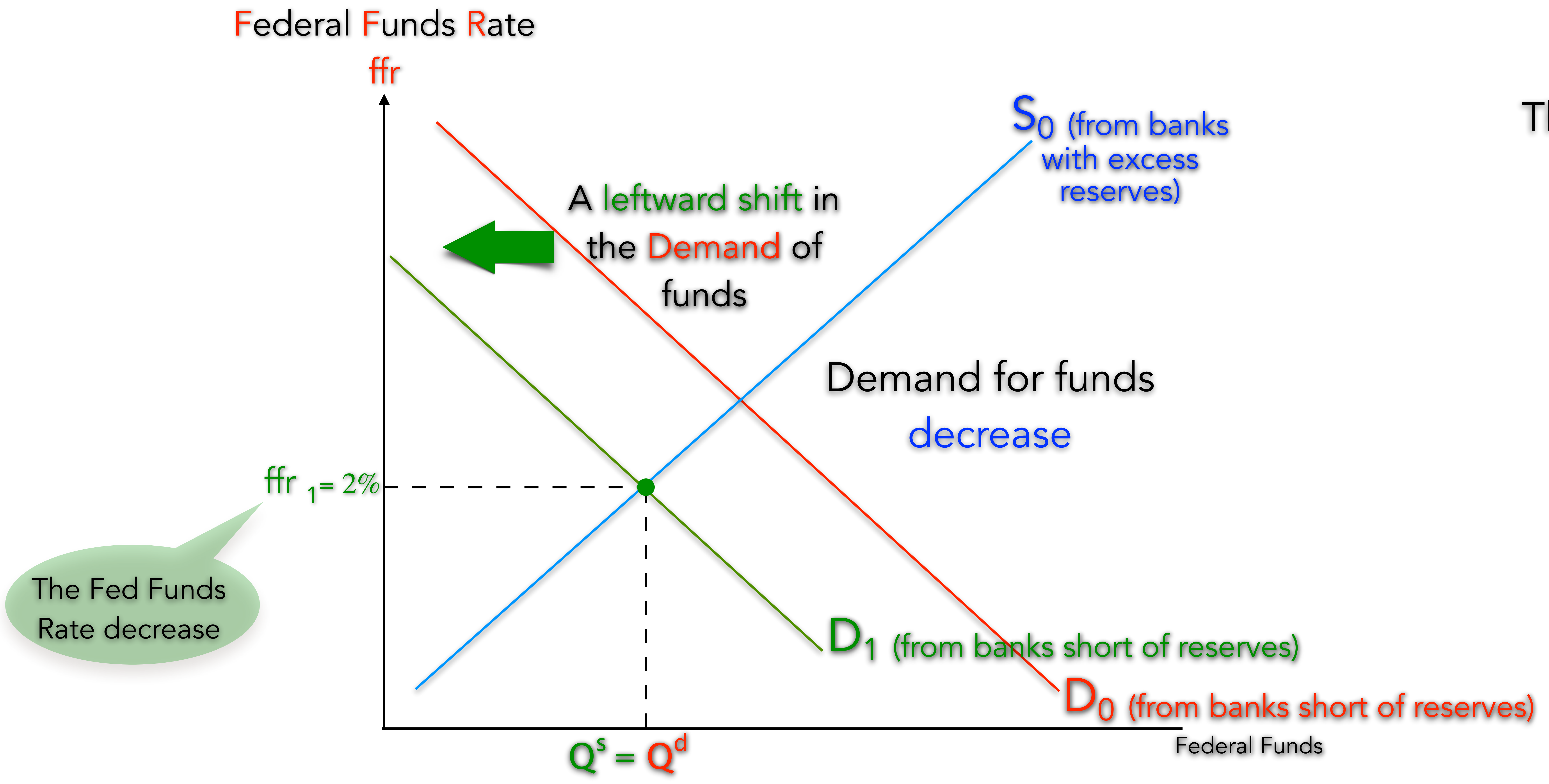
decrease

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