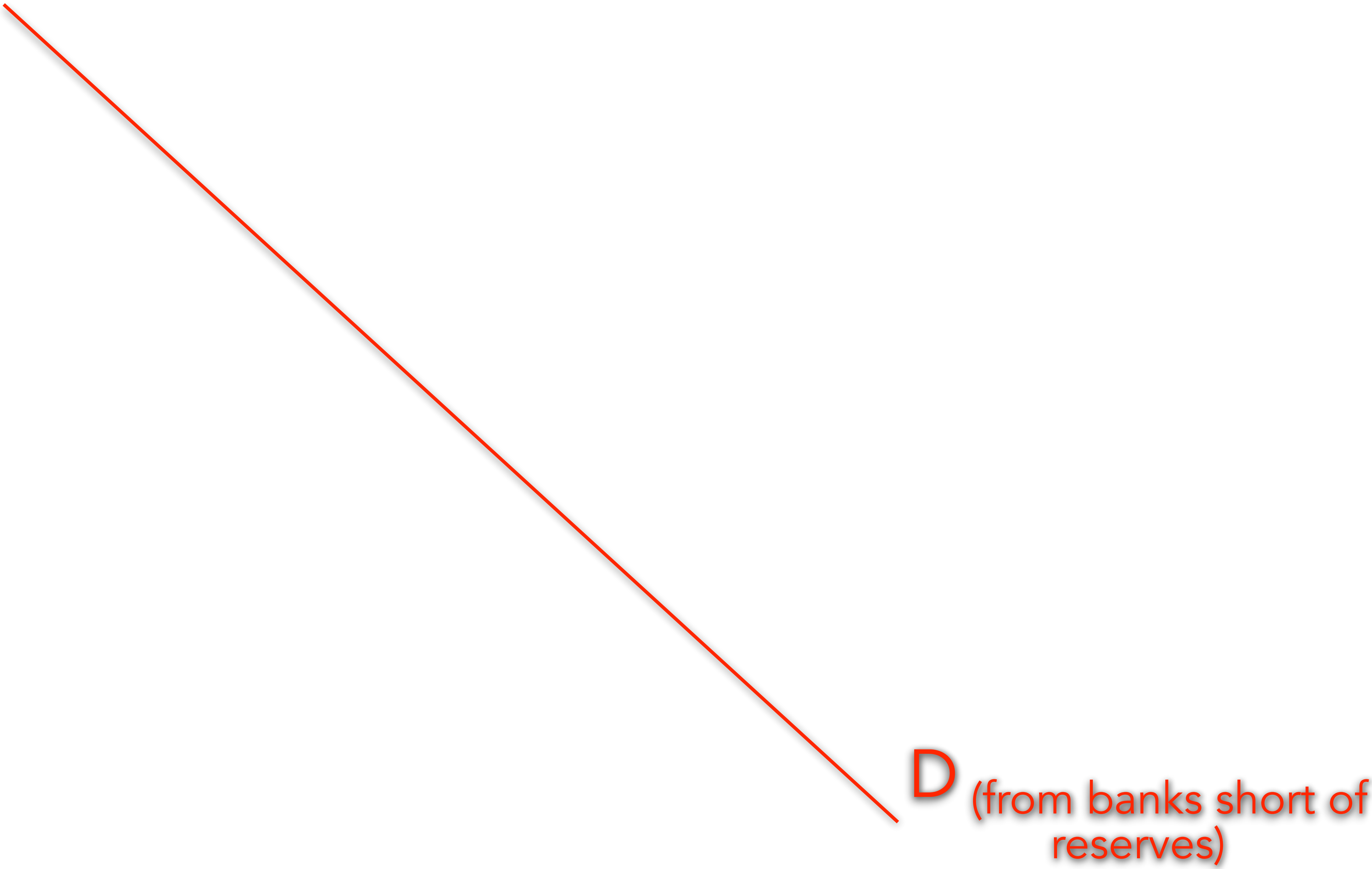
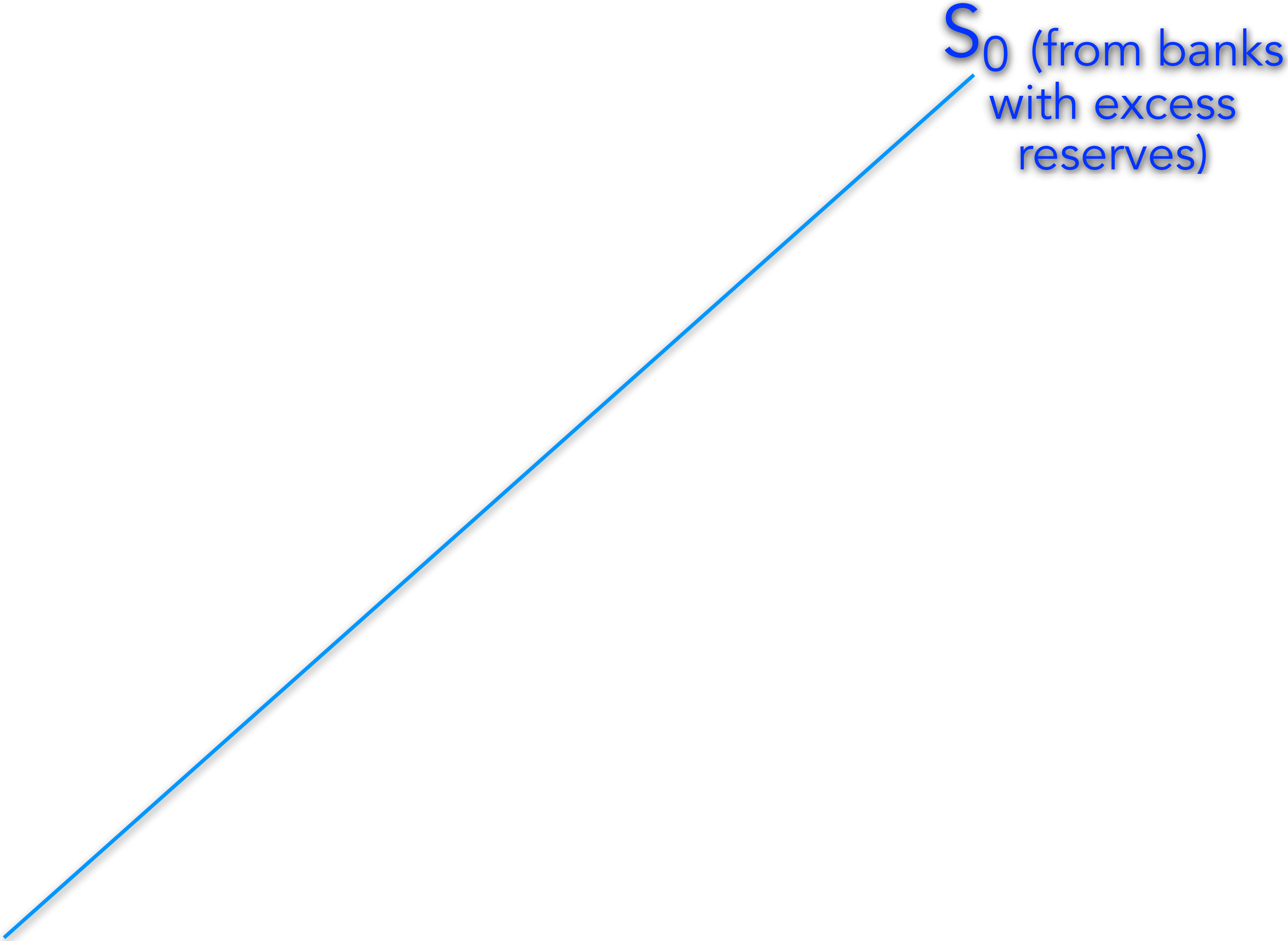

D (from banks short of reserves)

Federal Funds


S0 (from banks
with excess
reserves)

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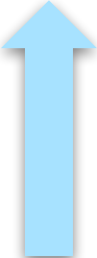
The effect of a purchase of bonds by the Fed on the Federal Funds Market

Fed buys Bonds:

Reserves

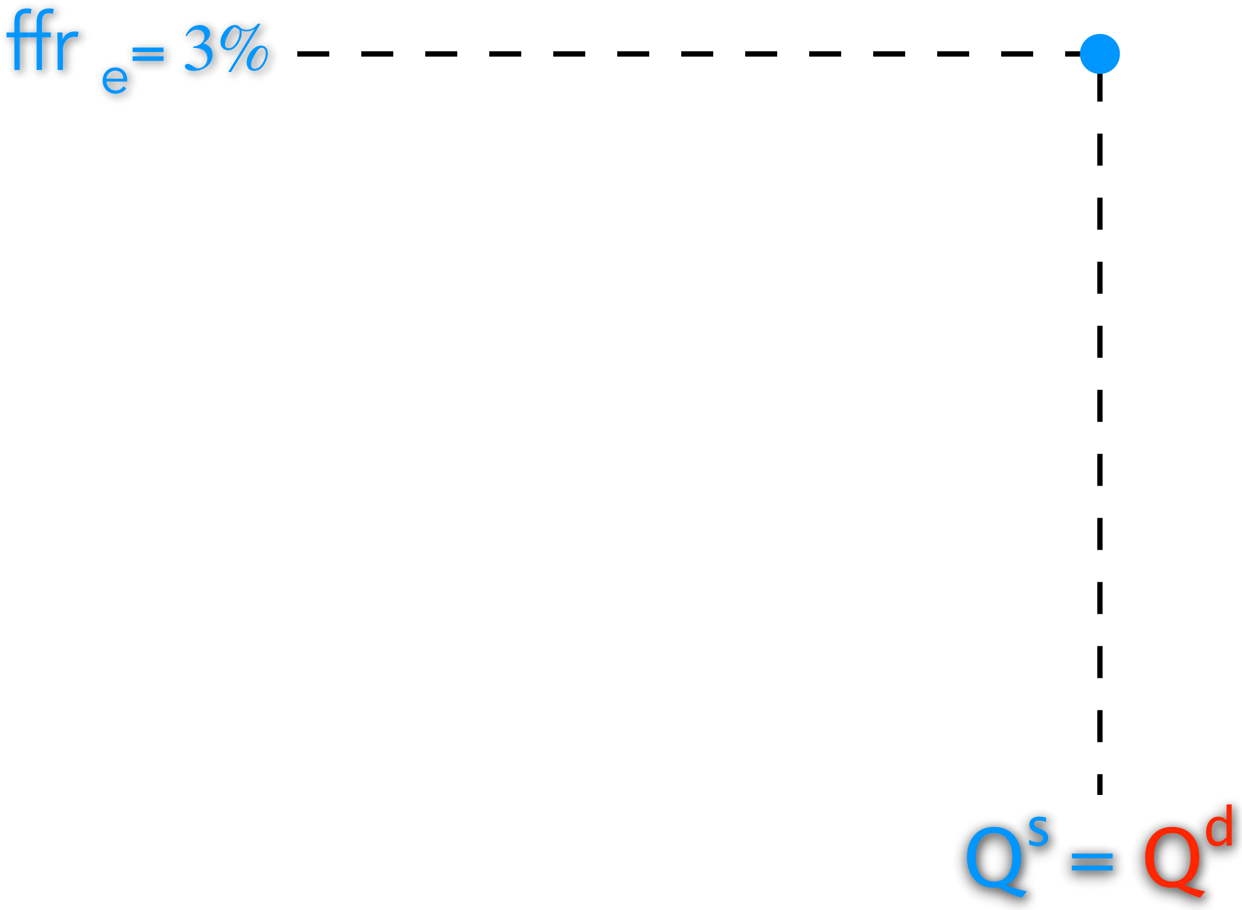


A purchase of bonds by the Fed floods the banking system with additional reserves

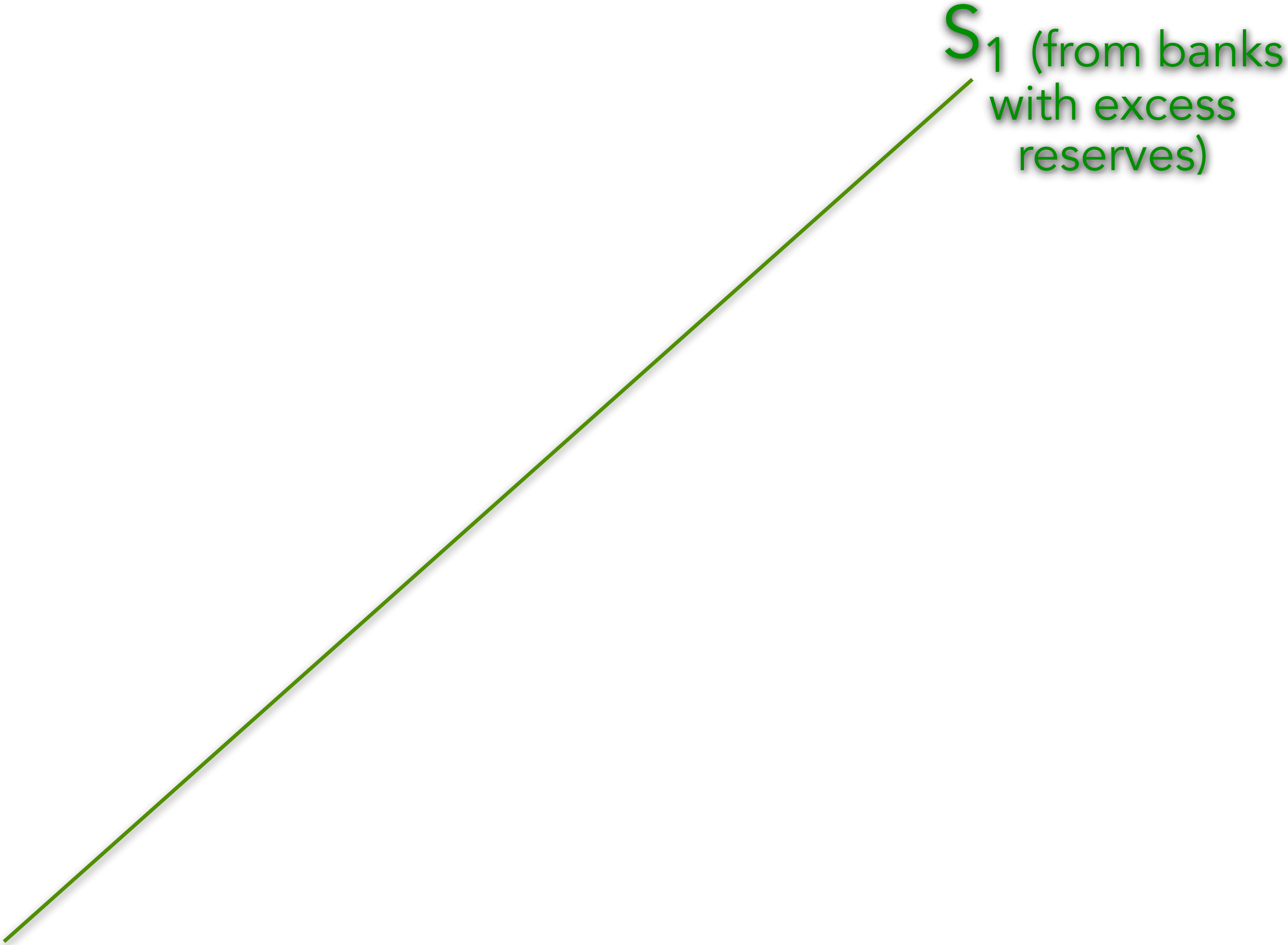
There will be more banks with excess Reserves

The **Supply** of funds in this market increase

A rightward shift in the Supply of funds


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

Assume the market starts at equilibrium



S_1 (from banks with excess reserves)

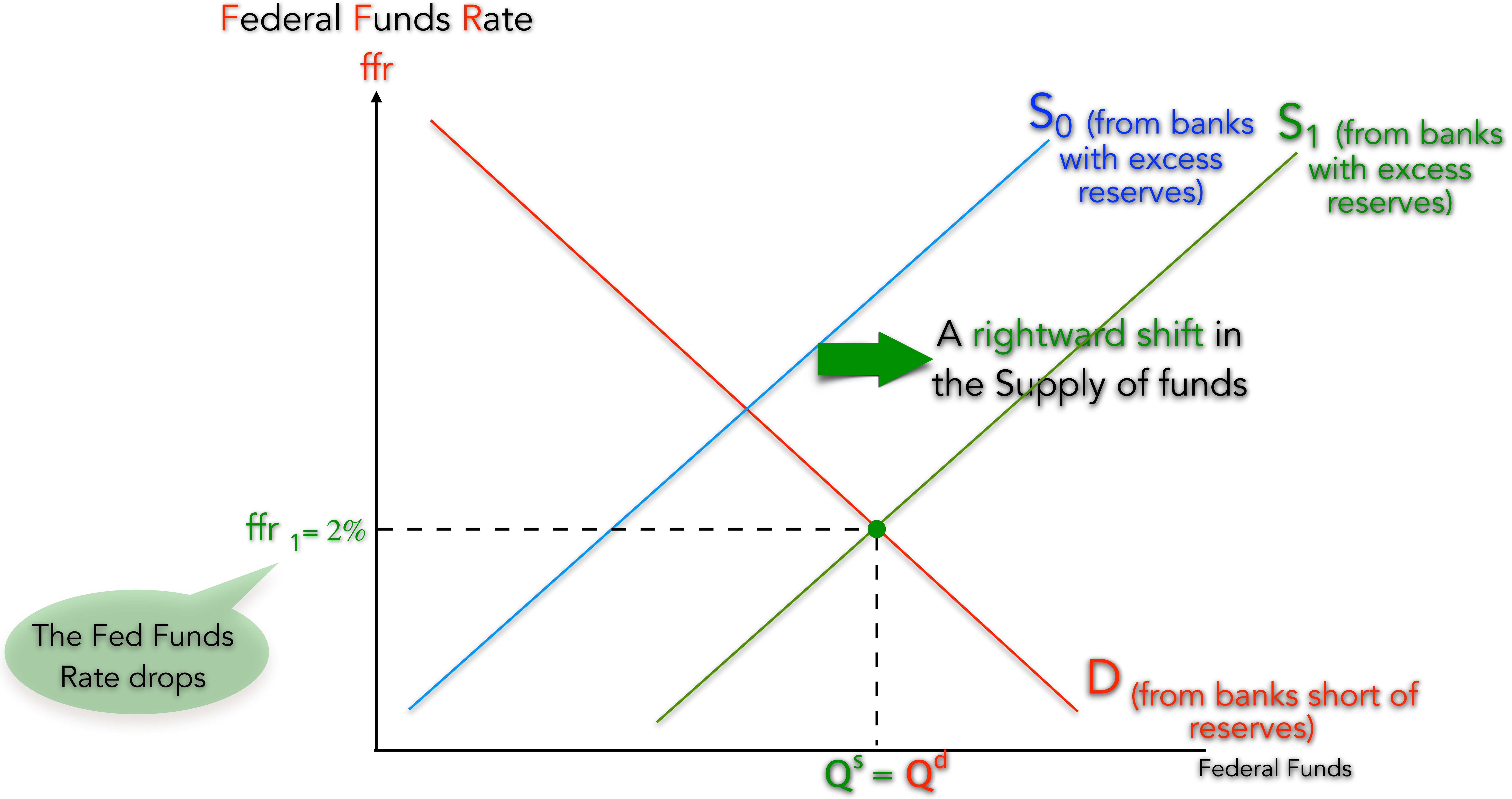

$ffr_1 = 2\%$
$Q^s = Q^d$

The Fed Funds
Rate drops

Federal Funds Rate

ffr

The effect of a purchase of bonds by the Fed on the Federal Funds Market



Fed buys Bonds: Reserves ↑

A purchase of bonds by the Fed floods the banking system with additional reserves

↓

There will be more banks with excess Reserves

↓

The **Supply** of funds in this market increase