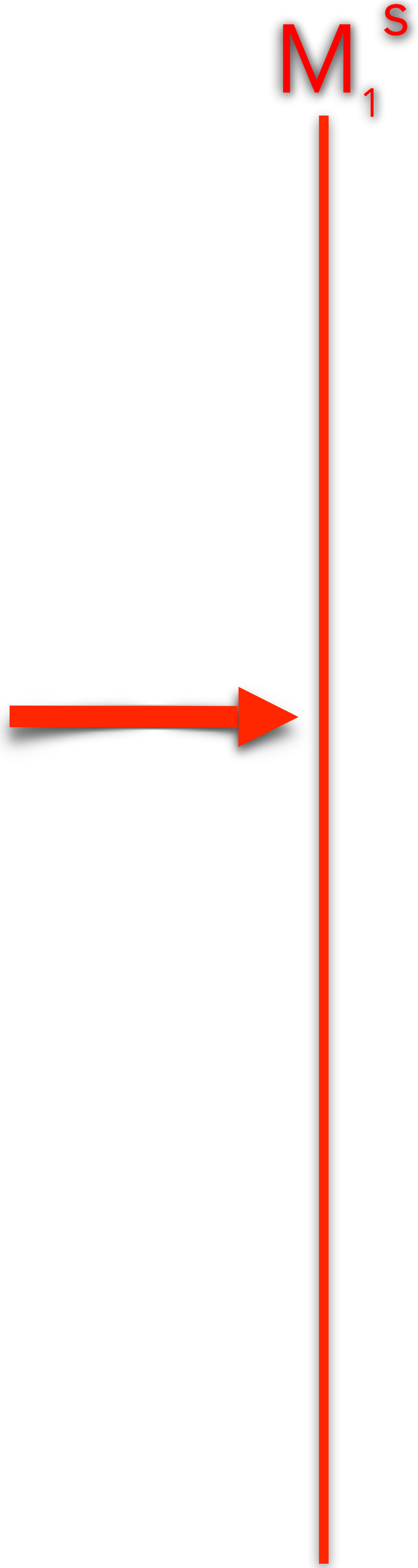

$M_1^s = 1,200b$

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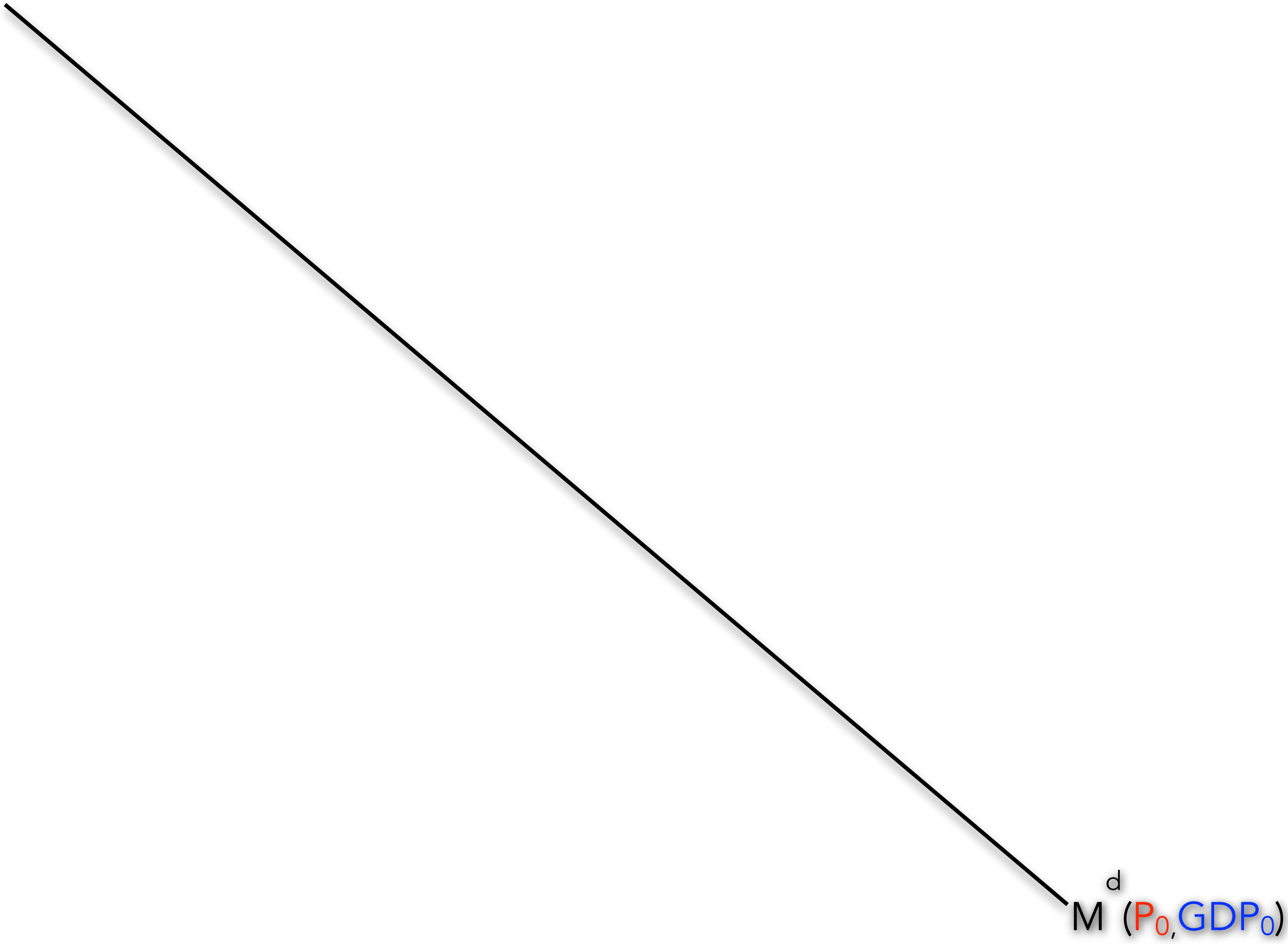
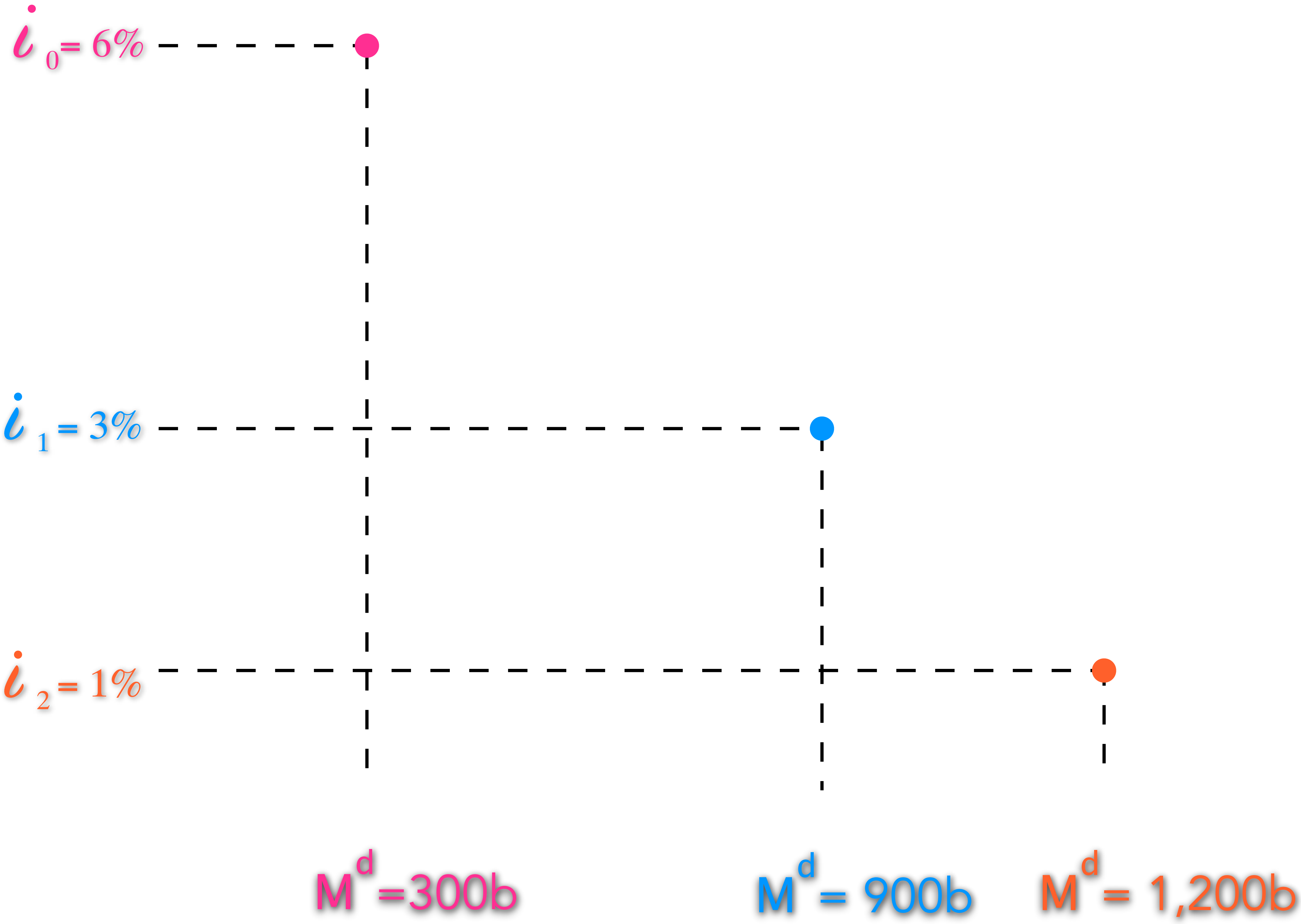
Currency+
Deposits

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

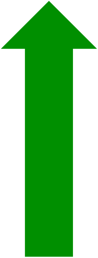
Assume the Money Market starts at equilibrium

Fed buys Bonds:

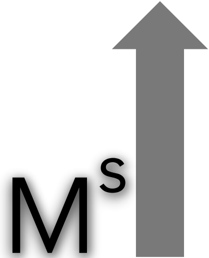
M^s shifts right

Reserves ↑

Loans



Deposits


Ms

When there are excess liquid balances, money is plentiful and there is pressure for the interest rate to fall excess liquid balances

The interest rate will fall to a new equilibrium at 1%


New
equilibrium

The Fed creates new reserves making money plentiful

The effect of a purchase of bonds by the Fed

The effect of a purchase of bonds by the Fed