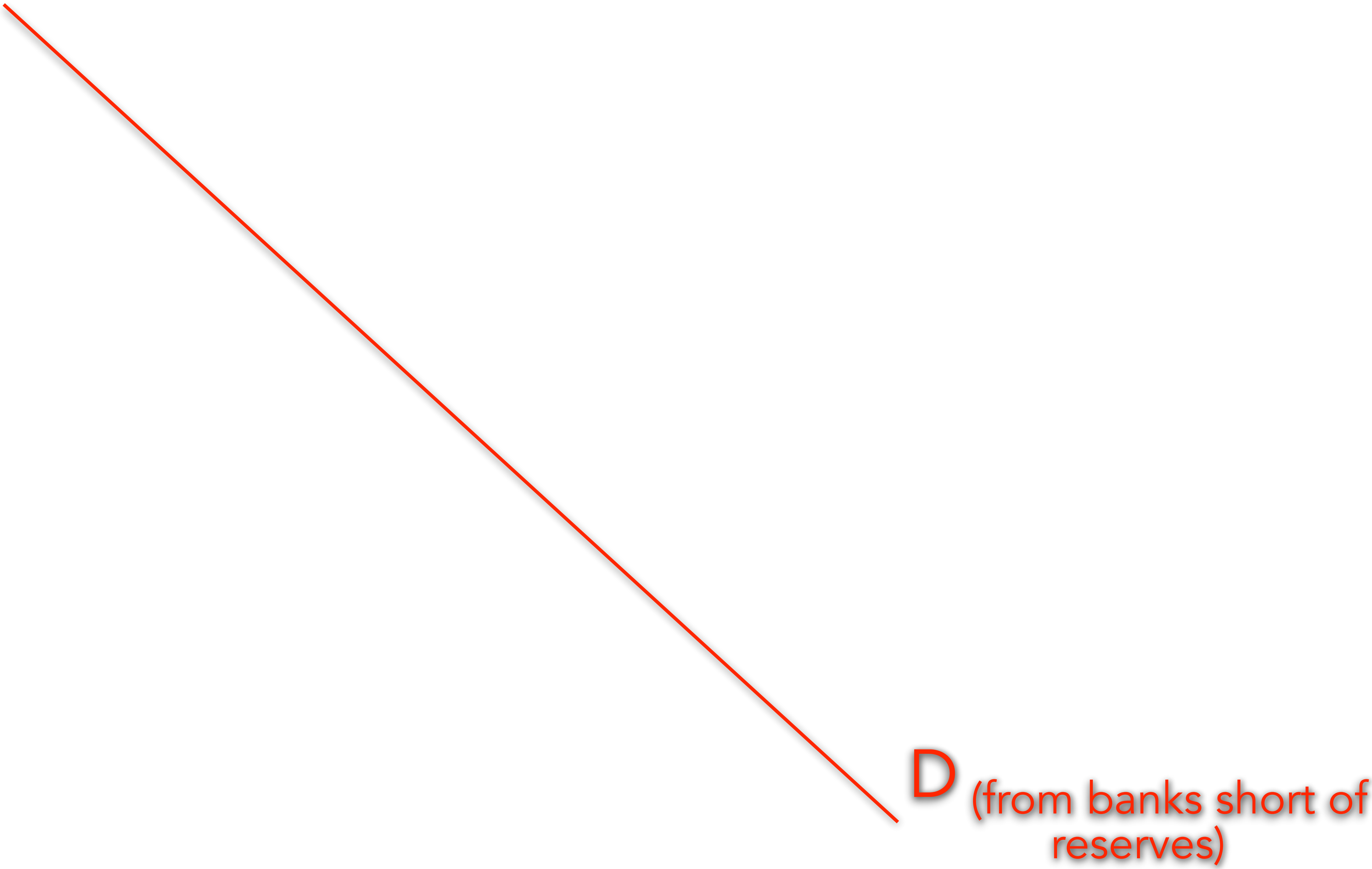
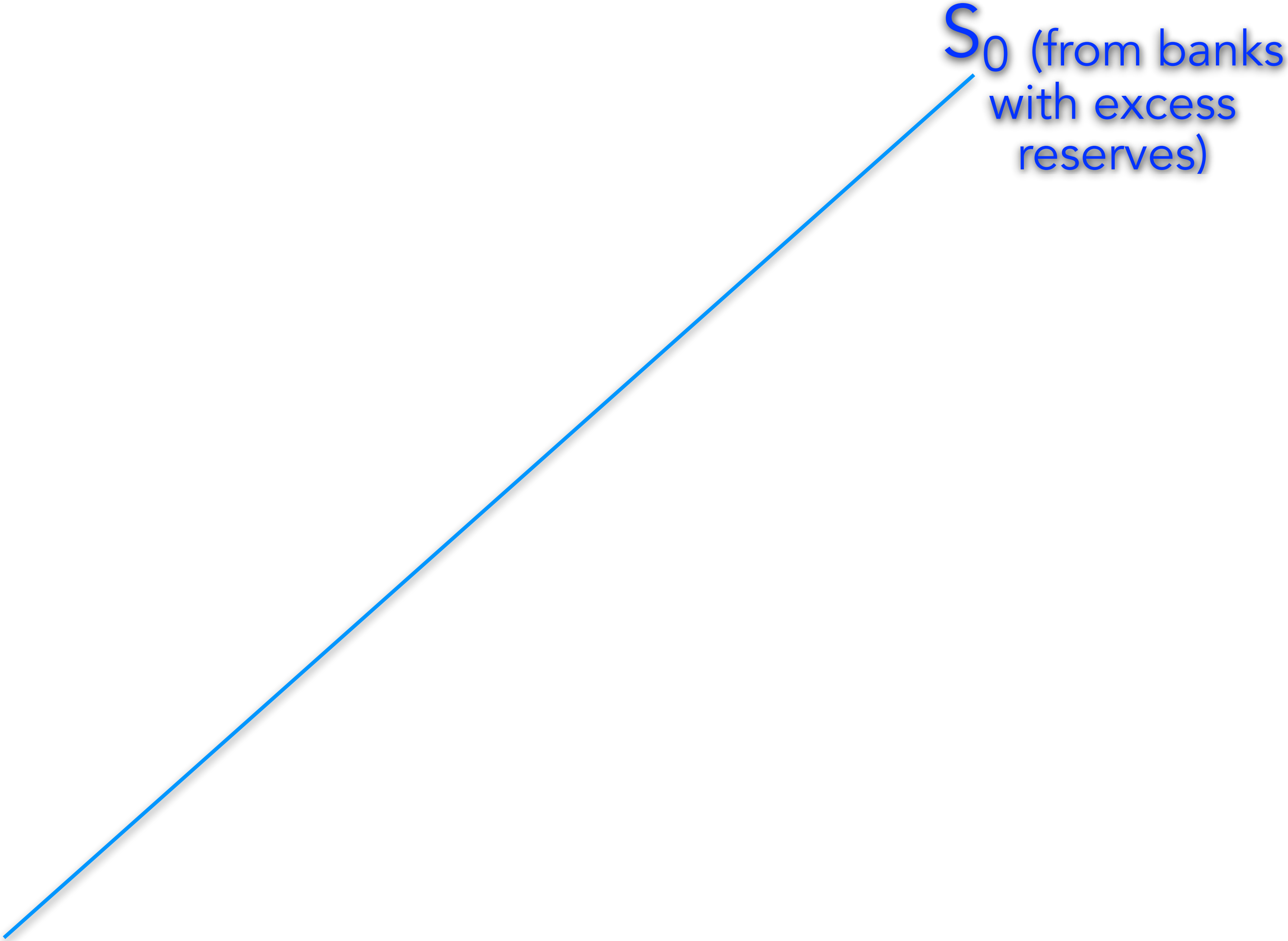

D (from banks short of reserves)

Federal Funds


S0 (from banks with excess reserves)

F

e

d

e

r

a

I

F

u

n

d

S

R

a

t

e

f

f

r

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

Fed buys Bonds:

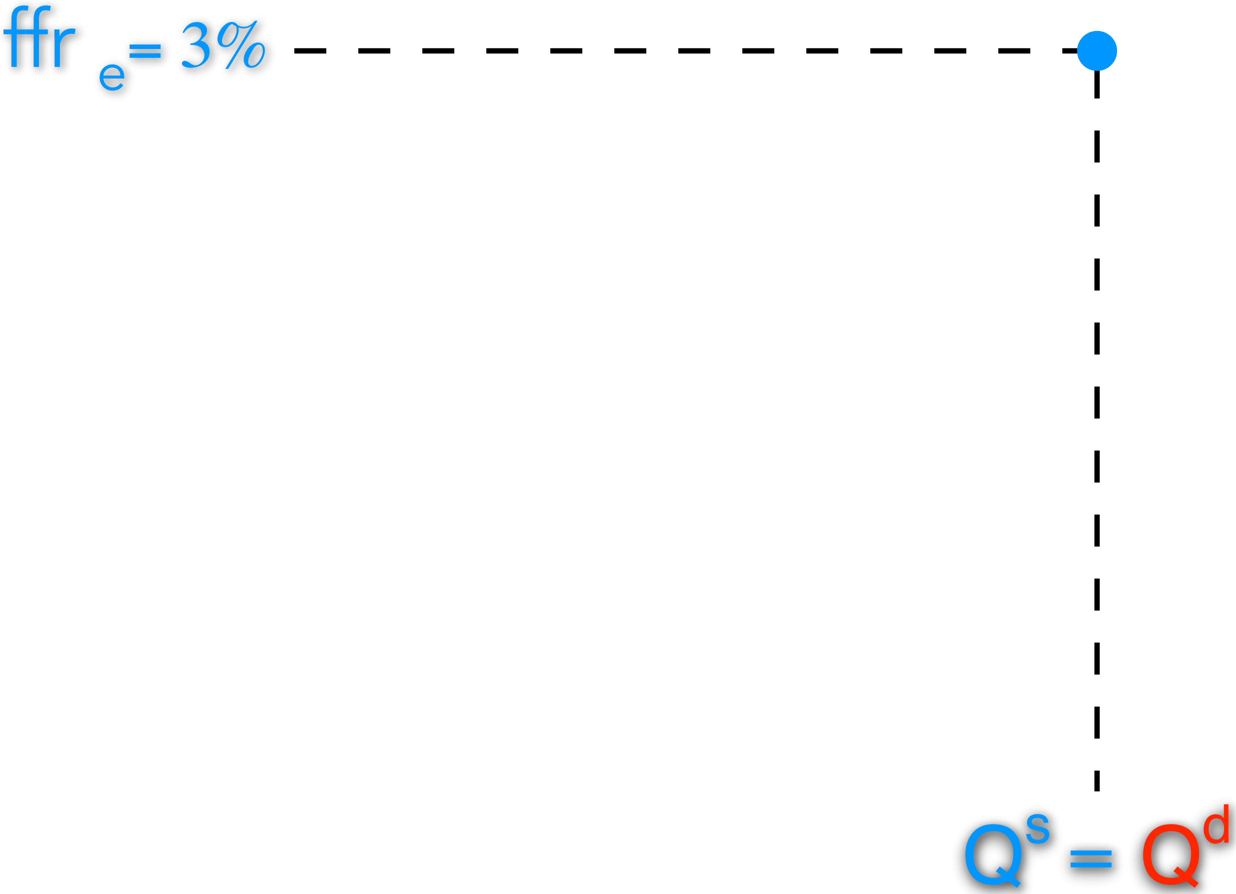
Reserves

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

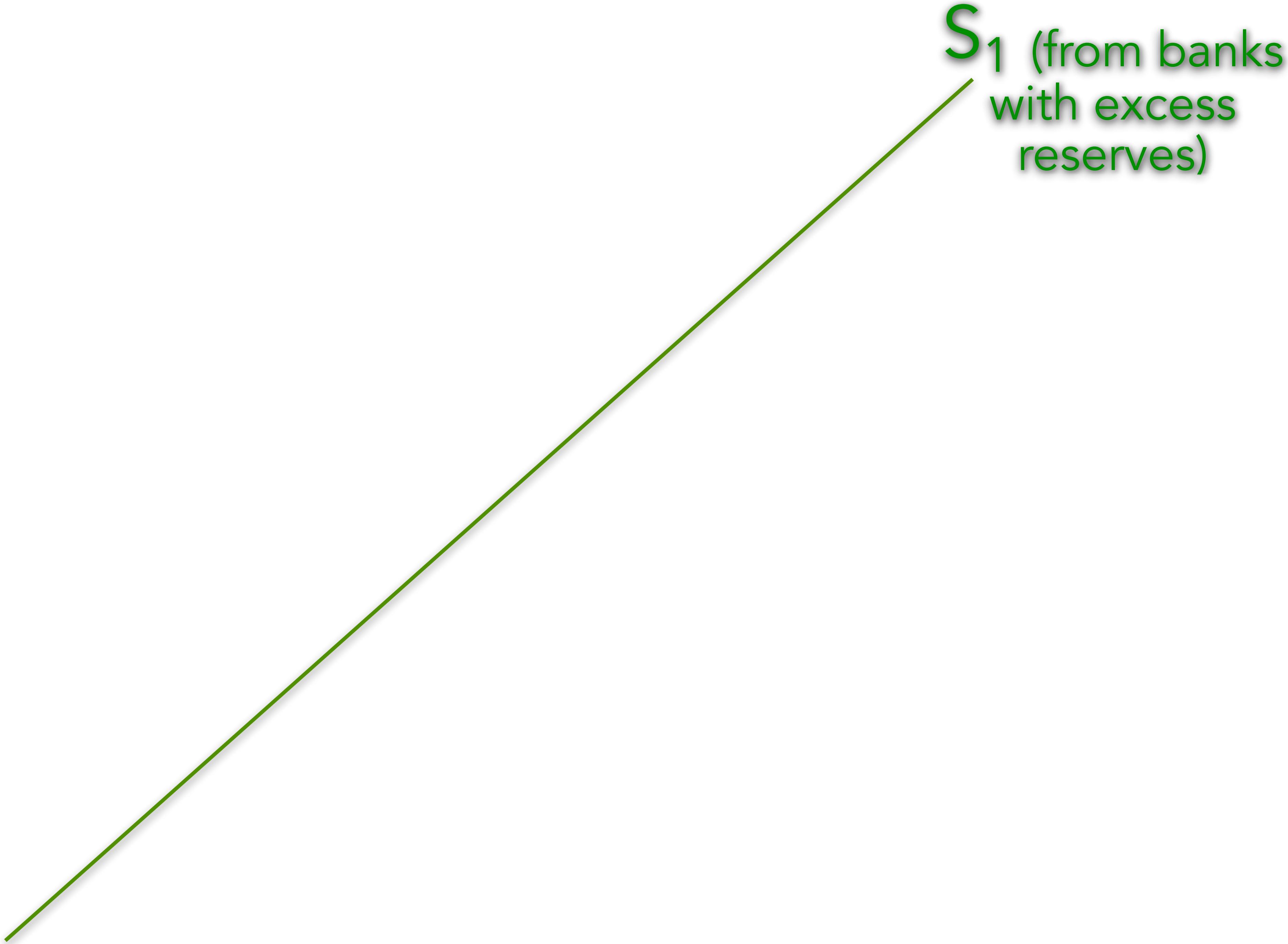
There will be more banks with excess Reserves

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%
$Q^s = Q^d$

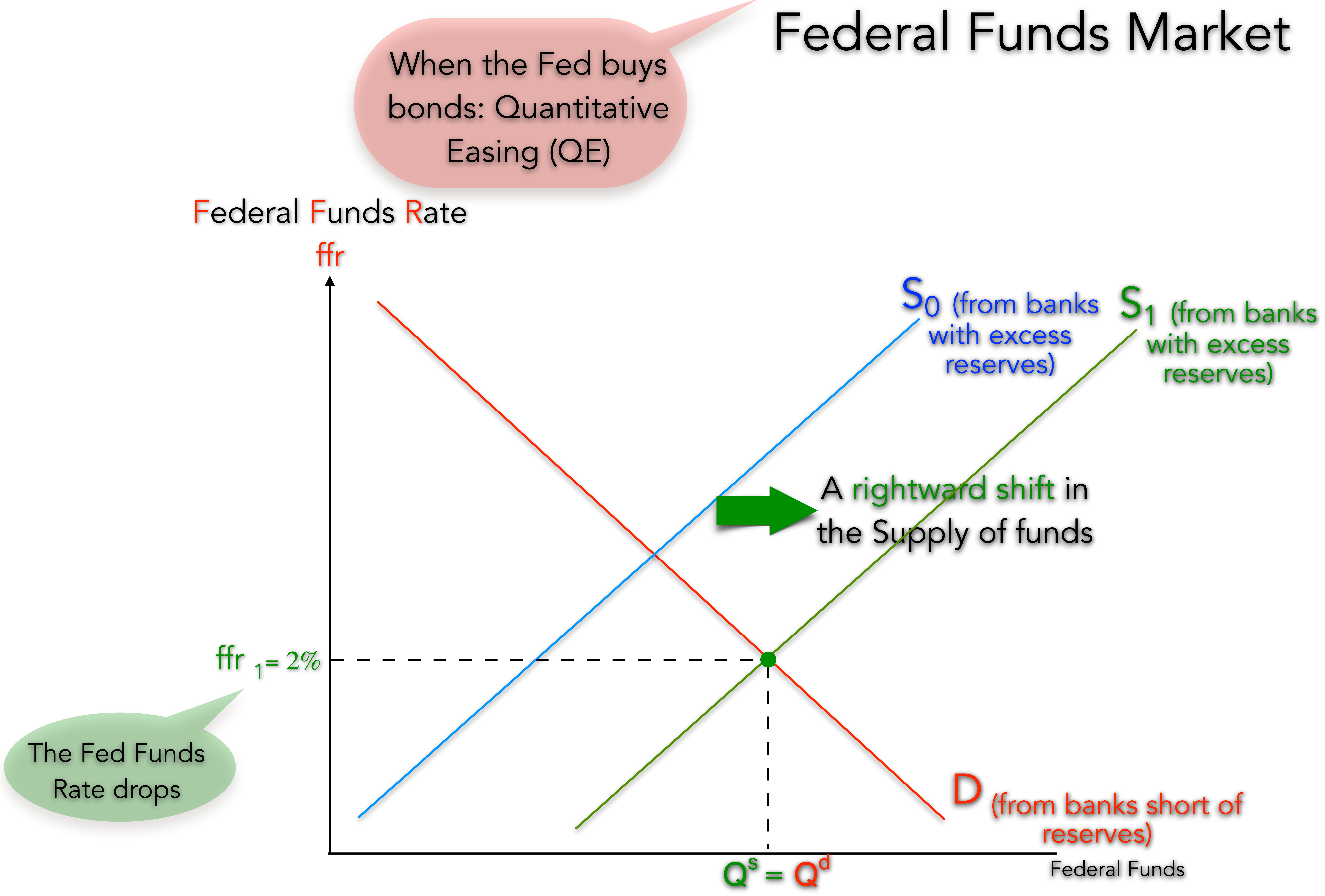
The Fed Funds
Rate drops

When the Fed buys bonds: Quantitative Easing (QE)

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