T

h

e

F

e

d

e

r

a

# F

u

n

d

# S

# M

a

r

k

e

t

A

t

t

h

e

e

n

d

O

f

b

u

S

i

n

e

S

# S

d

a

y

/

b

a

n

k

S

m

u

S

t

h

a

V

e

t

h

e

r

e

q

# u

i

r

e

d

a

m

O

u

n

t

O

f

r

S

e

r

V

e

S

R

=

r

*

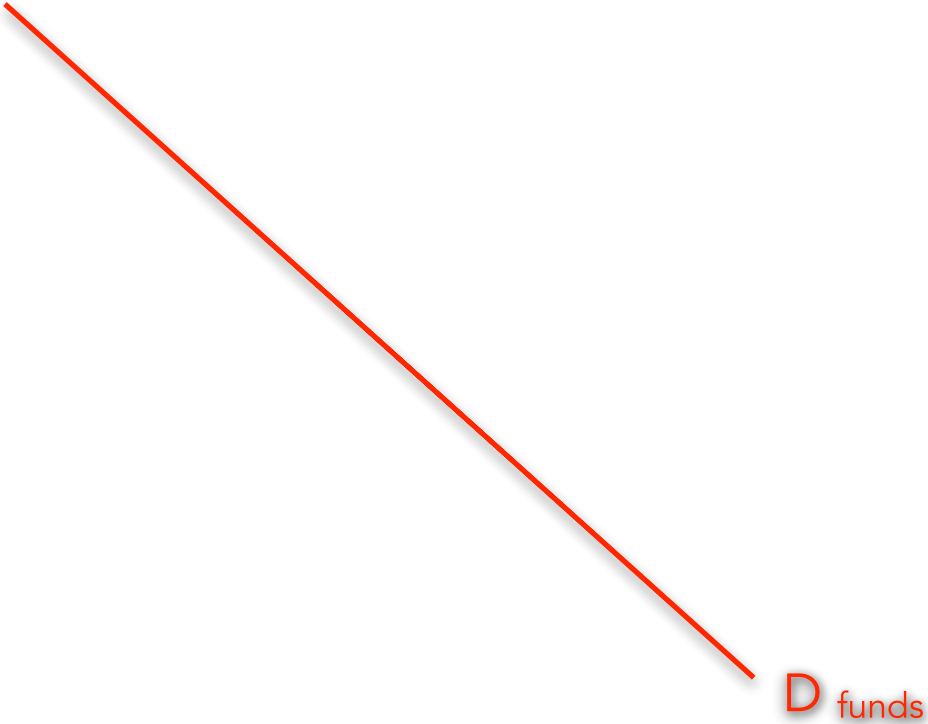
D

Some banks end with less in reserves than required

Some banks end the day with more reserves than required

# Borrowed Funds

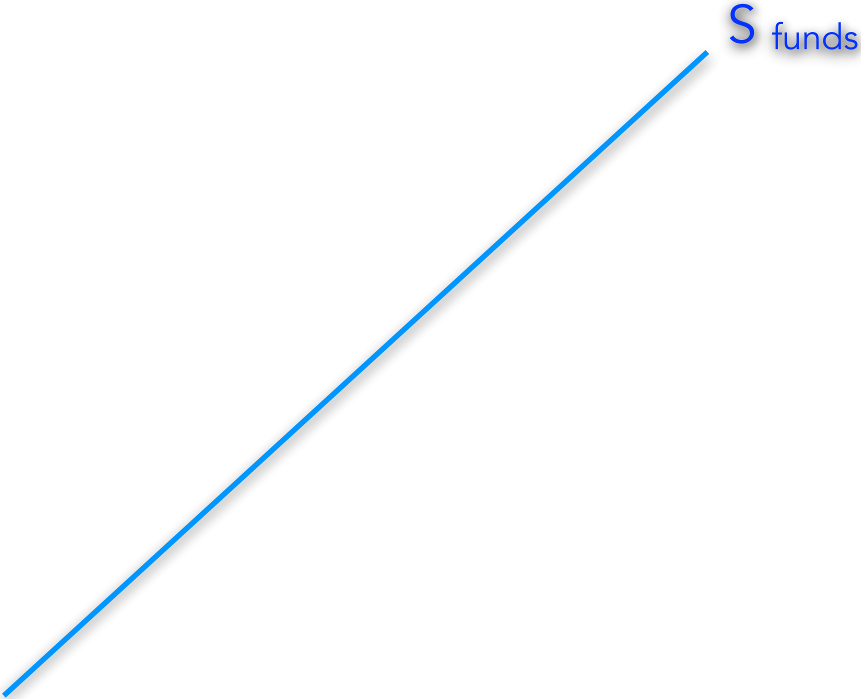
*i*


D funds

These banks want a low interest rate

# Loanable Funds

*i*


S funds

These banks want a high interest rate

These banks with excess reserves, want to lend these reserves to other banks

This creates a Supply of funds for lending

These banks short of reserves, must borrow reserves from other banks

This creates a Demand for borrowing funds

# B

e

C

a

u

S

e

t

h

e

S

e

# R

e

S

e

r

V

e

# S

a

r

e

h

e

|

d

a

S

d

e

p

O

# S

i

t

S

W

i

t

h

t

h

e

F

e

d

/

t

h

i

S

m

a

r

k

e

t

i

S

C

a

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

Because these **Reserves** are held as deposits with the Fed, this market is called

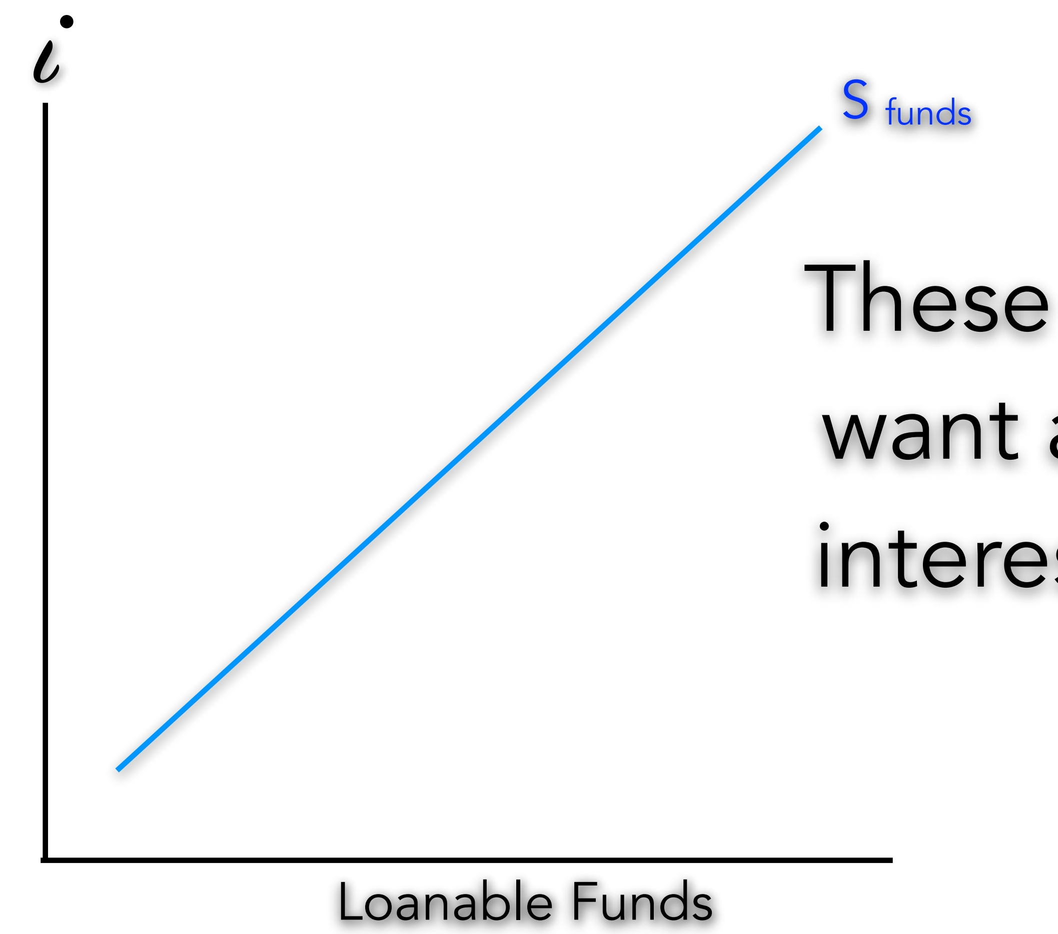
# The Federal Funds Market

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

Some banks end the day with more reserves than required

These banks with excess reserves, want to lend these reserves to other banks

This creates a Supply of funds for lending

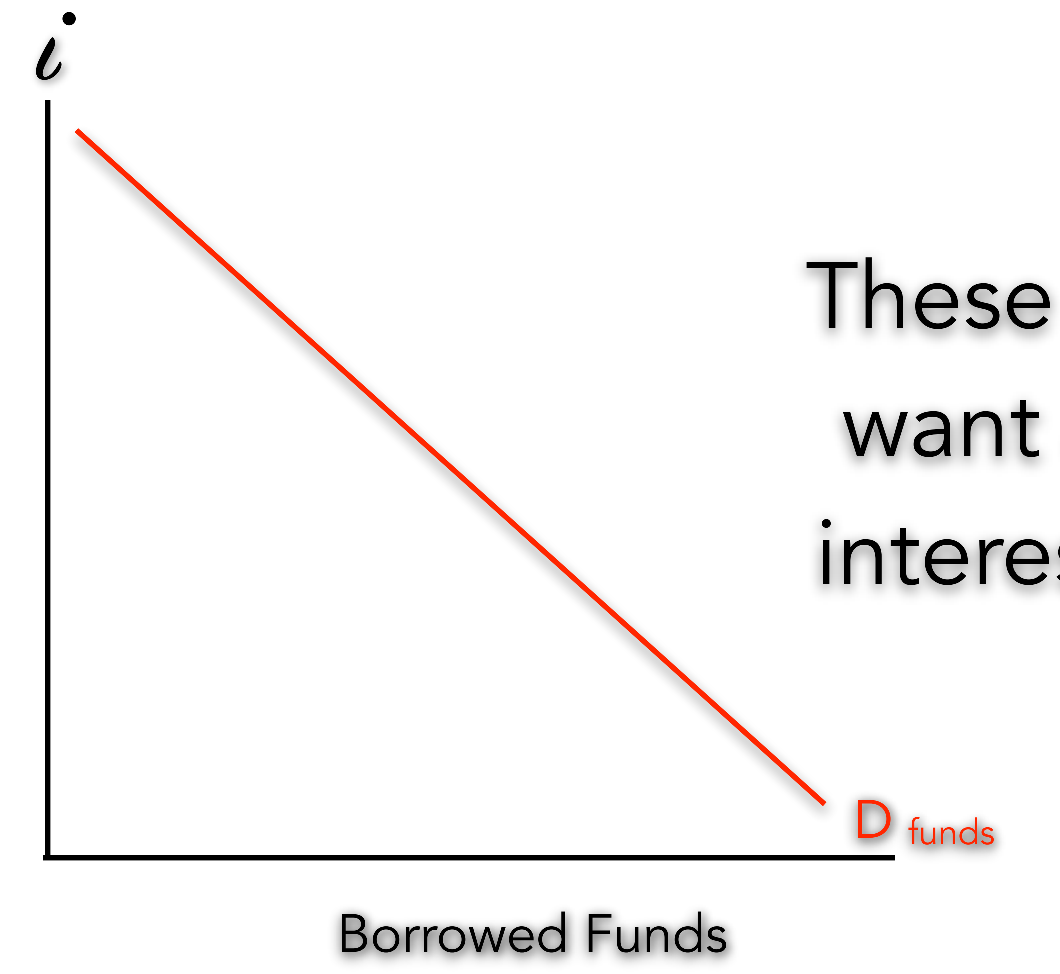



These banks want a high interest rate

Some banks end with less in reserves than required

These banks short of reserves, must borrow reserves from other banks

This creates a Demand for borrowing funds




These banks want a low interest rate

# The Federal Funds Market