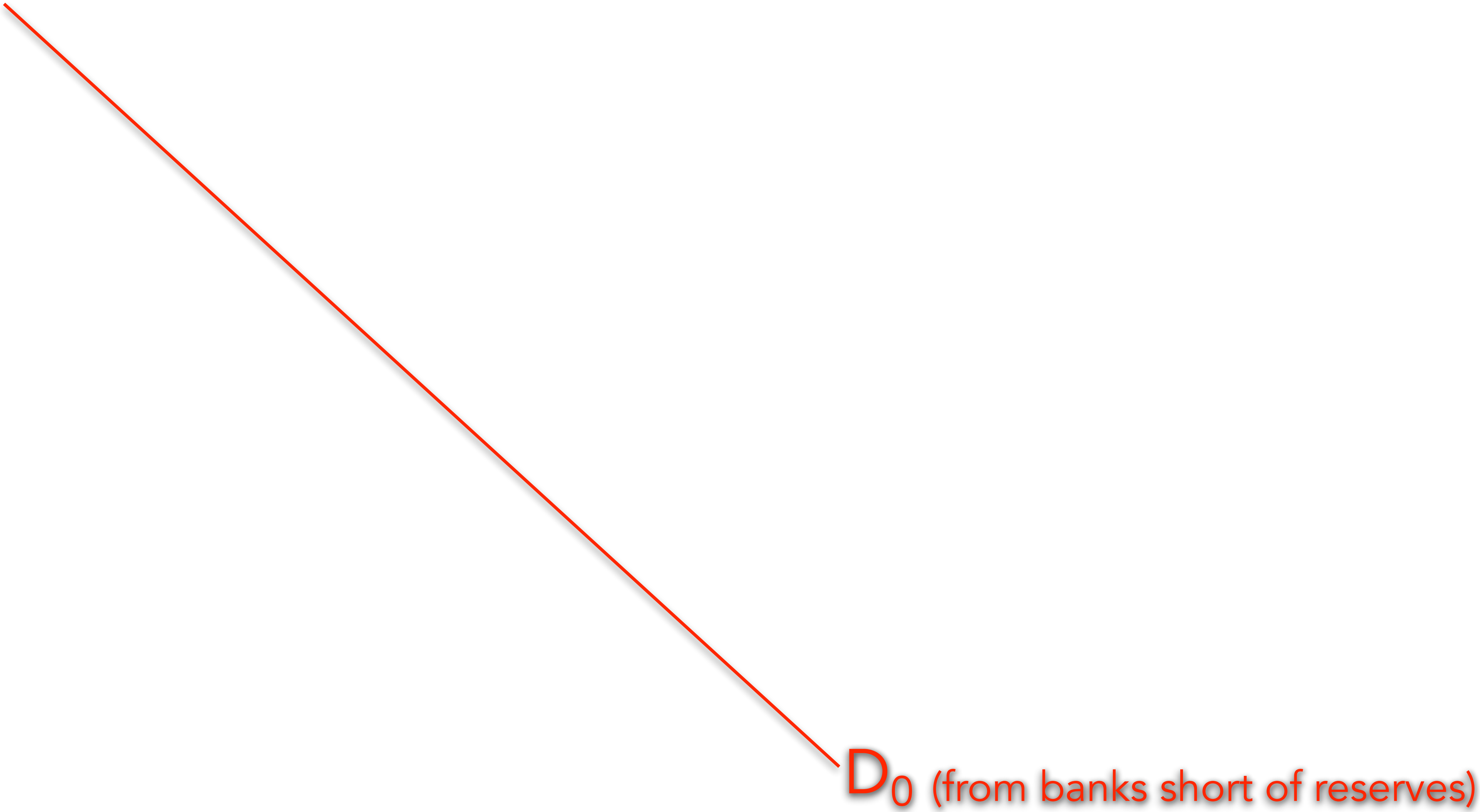
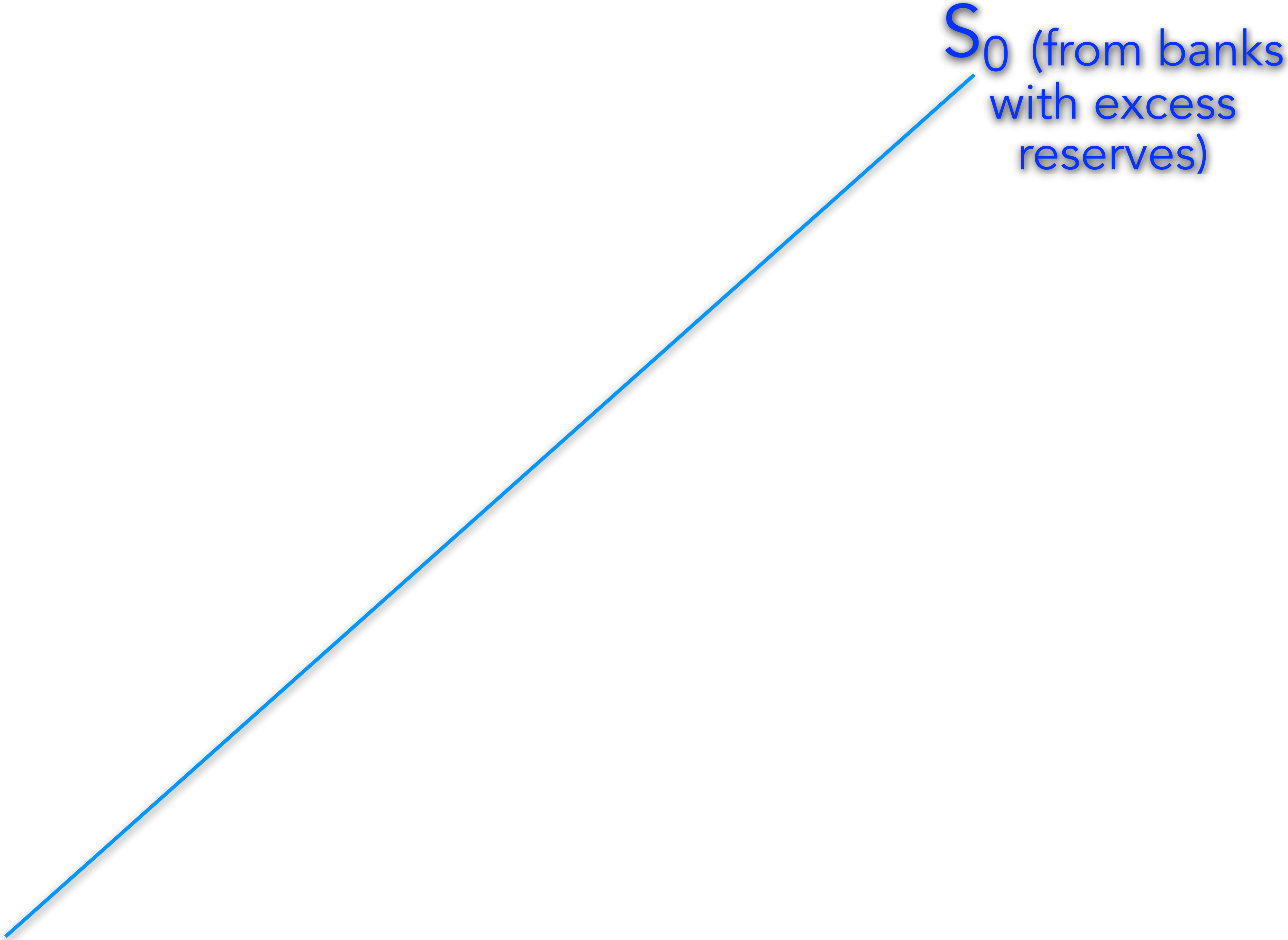

D_0 (from banks short of reserves)


S0 (from banks
with excess
reserves)

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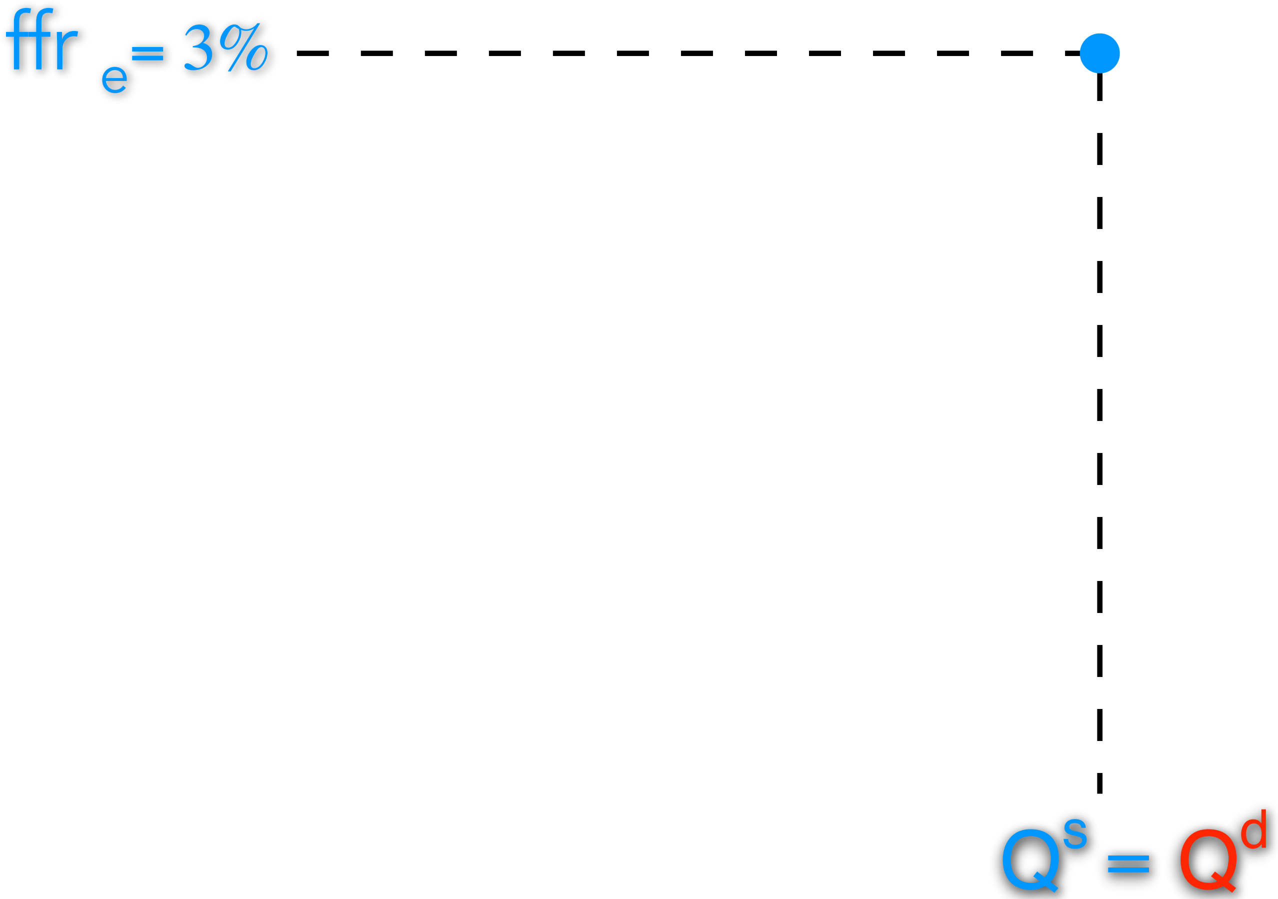
The effect of a decrease in GDP on the Federal Funds Rate

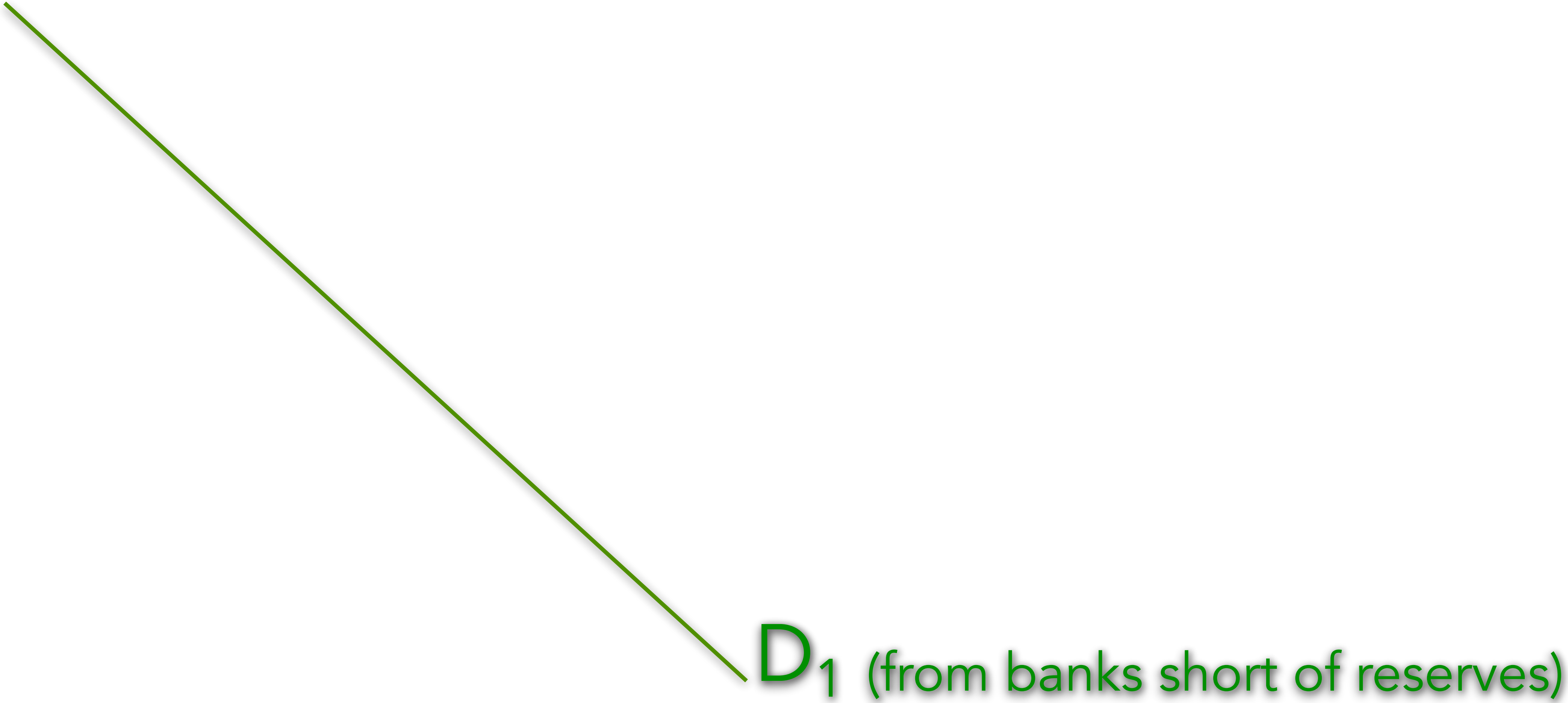
The public deposits a smaller portion of their income in checking accounts

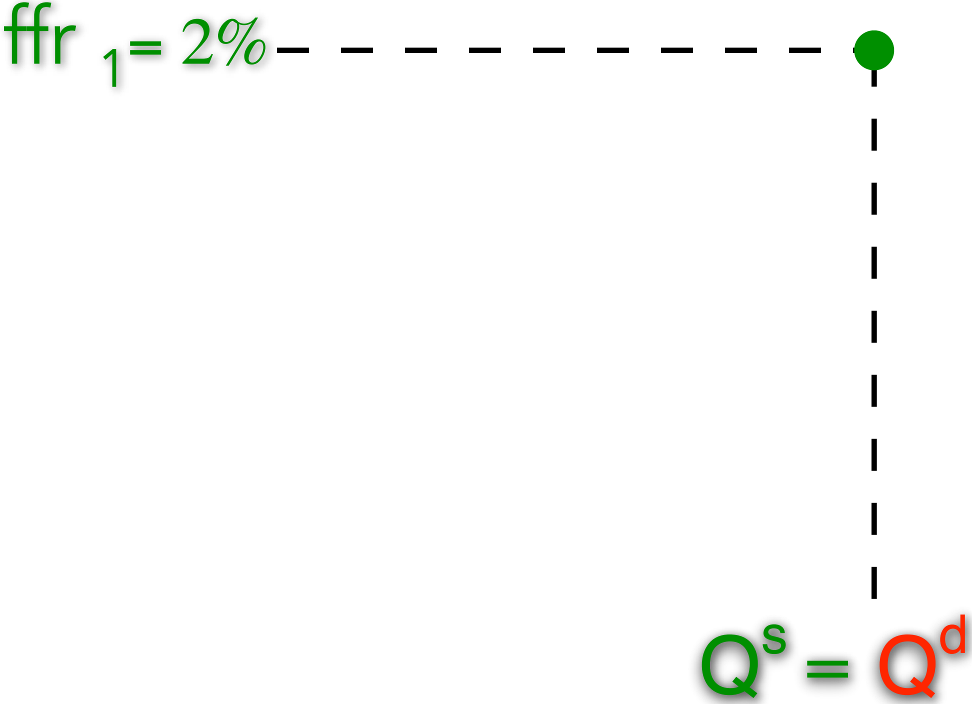
Deposits decrease

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)



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

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

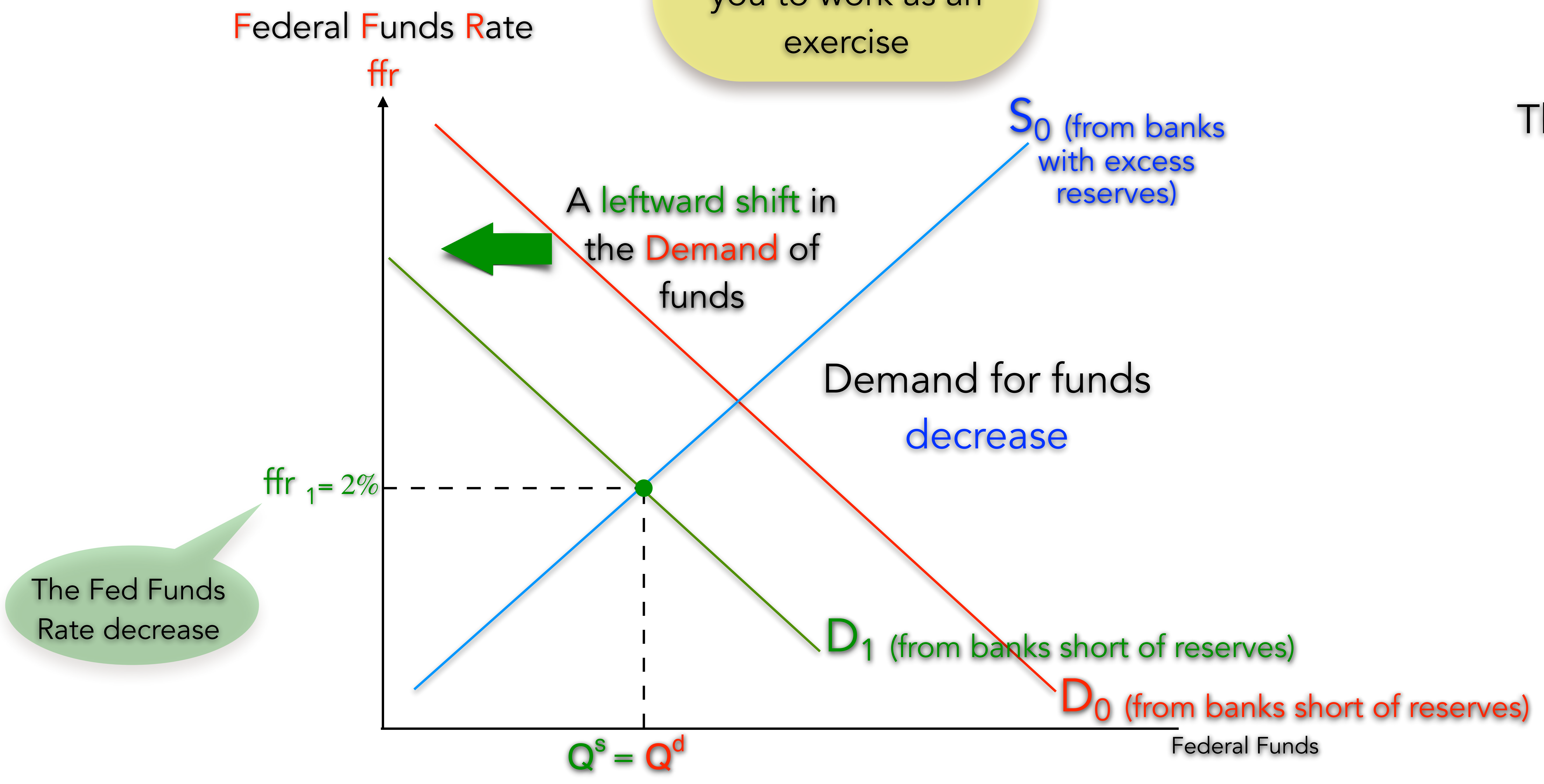
I leave the effect of a Increase in GDP to you to work as an exercise

Federal Funds Rate

ffr

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

I leave the effect of a Increase in GDP to you to work as an exercise



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