$$D = 250$$

$$r = 10\%$$

AR=RR=25

$L = 225$

To understand what happens next, we must take a closer look at the loan process

Bank A

This means that as loans are paid back new loans are issued so that total loans outstanding stay always at 225b

T

h

e

F

e

d

/

S

S

a

I

e

O

f

b

O

n

d

S

d

e

C

r

e

a

S

e

b

O

t

h

:

D

e

p

O

S

i

t

S

a

n

d

R

e

S

e

r

V

e

S

Bank A is actually holding the exact amount of reserves it is required to hold

$RR = 24.4$

-6

-6

AR=19

The bank is now short of reserves

New D=244

Short = 5.4

As loans are paid back, fewer loans are issued until reserves are built up to the legal amount

-5.4

New L = 219.6

A

S

a

e

O

f

b

O

n

d

S

b

y

t

h

e

F

e

t

r

i

g

g

e

r

S

a

d

e

C

r

e

a

S

e

i

n

d

p

O

S

i

t

S

b

e

C

a

u

S

e

t

h

e

p

u

b

I

i

C

p

a

y

S

W

i

t

h

C

h

e

C

k

S

d

r

a

W

n

O

n

t

h

e

i

r

b

a

n

k

a

C

C

O

u

n

t

S

T

h

e

S

a

m

e

W

i

I

h

a

p

p

e

n

f

O

r

a

b

a

n

k

S

i

n

t

h

e

b

a

n

k

i

n

g

S

y

S

t

e

m

:

I

S

W

i

I

d

e

C

r

e

a

S

e

L

O

a

n

S

A

S

a

e

O

f

b

O

n

d

S

b

y

t

h

e

F

e

t

r

i

g

g

e

r

S

a

d

e

C

r

e

a

S

e

i

n

a

C

t

u

a

r

e

S

e

r

V

e

S

b

e

C

a

u

e

t

h

e

F

e

d

d

e

C

r

e

S

e

S

r

e

S

e

r

V

S

i

n

a

b

a

k

S

This is the
drop for
Bank A

A sale of bonds by the Fed triggers a decrease in deposits because the public pays with checks drawn on their bank accounts

A sale of bonds by the Fed triggers a decrease in actual reserves because the Fed decreases reserves in all banks

The Fed’s sale of bonds decrease both:

Deposits and Reserves

To understand what happens next, we must take a closer look at the loan process

Bank A is actually holding the exact amount of reserves it is required to hold

The bank is now short of reserves

Bank A

r=10%

AR=RR=25	D = 250
-6	-6
AR=19	New D=244
- RR=24.4	
Short = 5.4	
L= 225	
-5.4	
New L = 219.6	

This is the drop for Bank A

As loans are paid back, fewer loans are issued until reserves are built up to the legal amount

A sale of bonds by the Fed triggers a decrease in deposits because the public pays with checks drawn on their bank accounts

A sale of bonds by the Fed triggers a decrease in actual reserves because the Fed decreases reserves in all banks

The Fed's sale of bonds decrease both: Deposits and Reserves

The same will happen for all banks in the banking system: all banks will decrease Loans