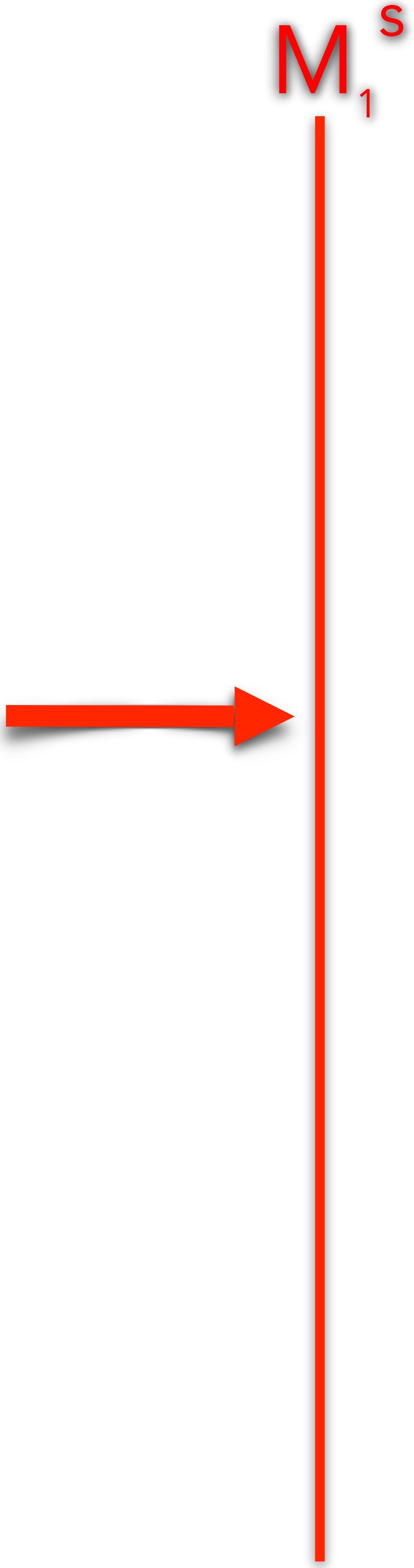

$M_1^s = 1{,}200b$

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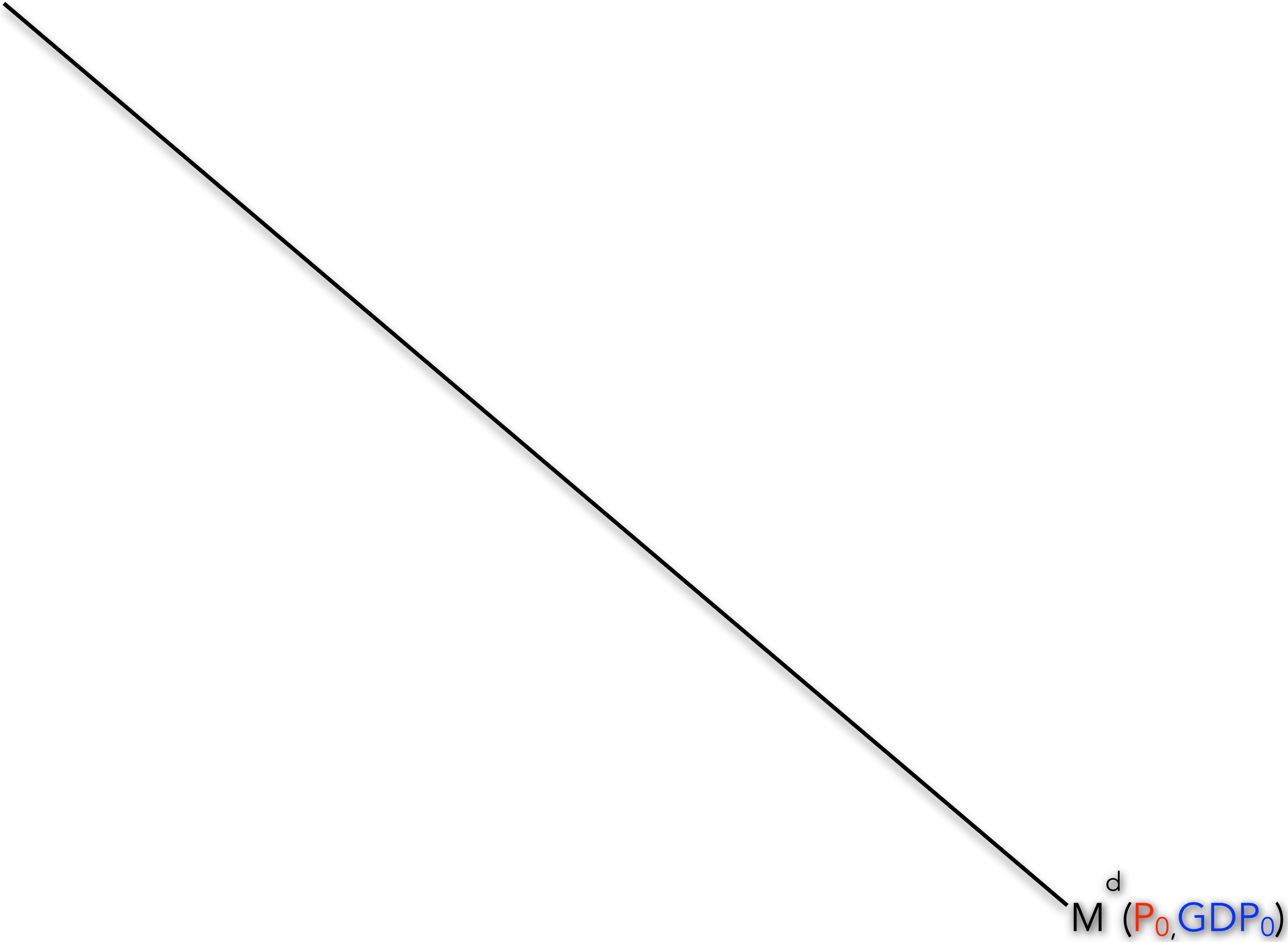
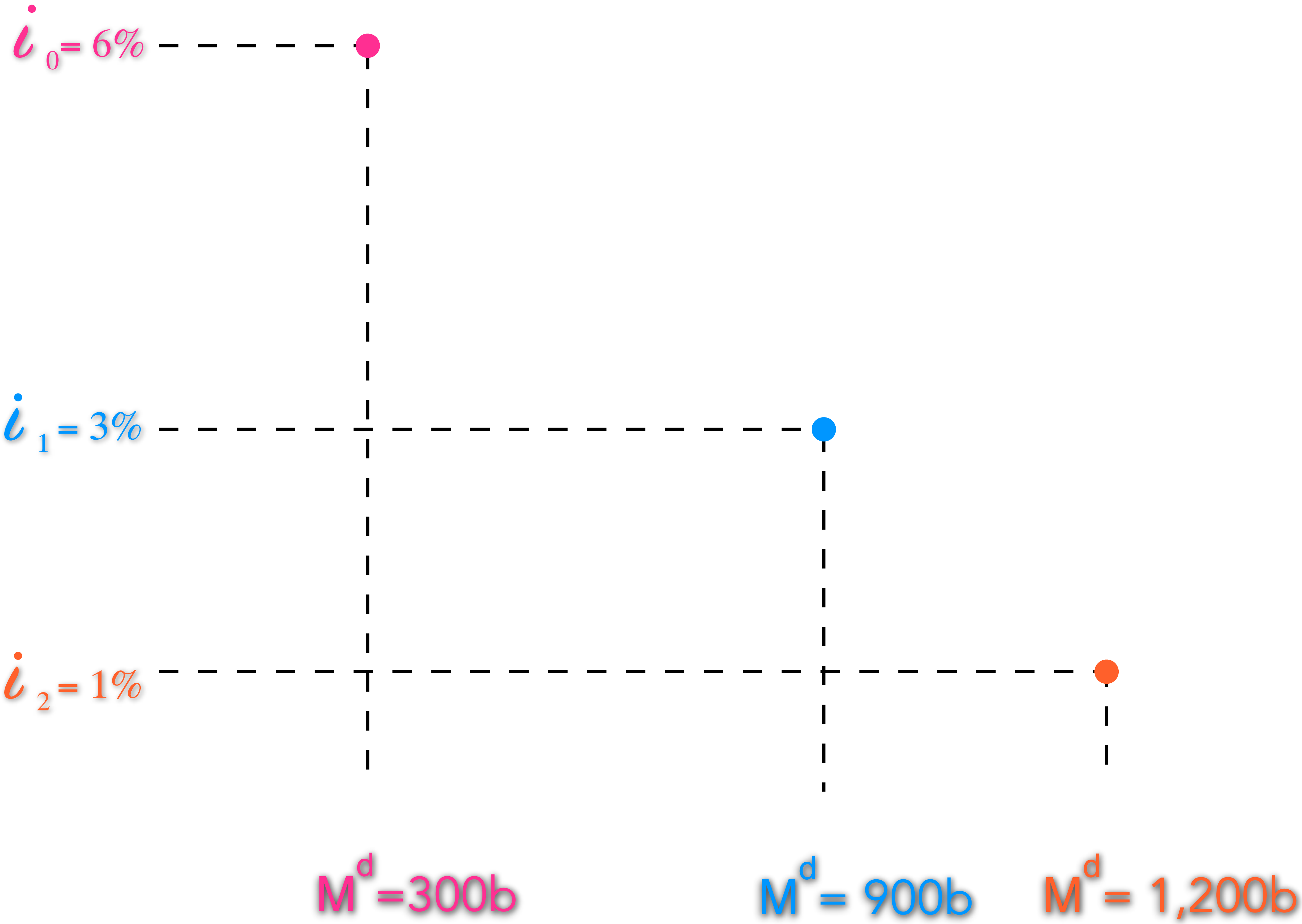
Currency+
Deposits

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 at 3%

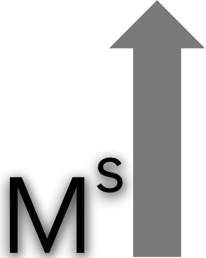
Fed buys Bonds:

M^s shifts right

Reserves

Loans

Deposits


M^s

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

When the Fed buys bonds: Quantitative Easing (QE)

The Fed creates new reserves making money plentiful at 3%

The effect of a purchase of bonds by the Fed

The effect of a purchase of bonds by the Fed