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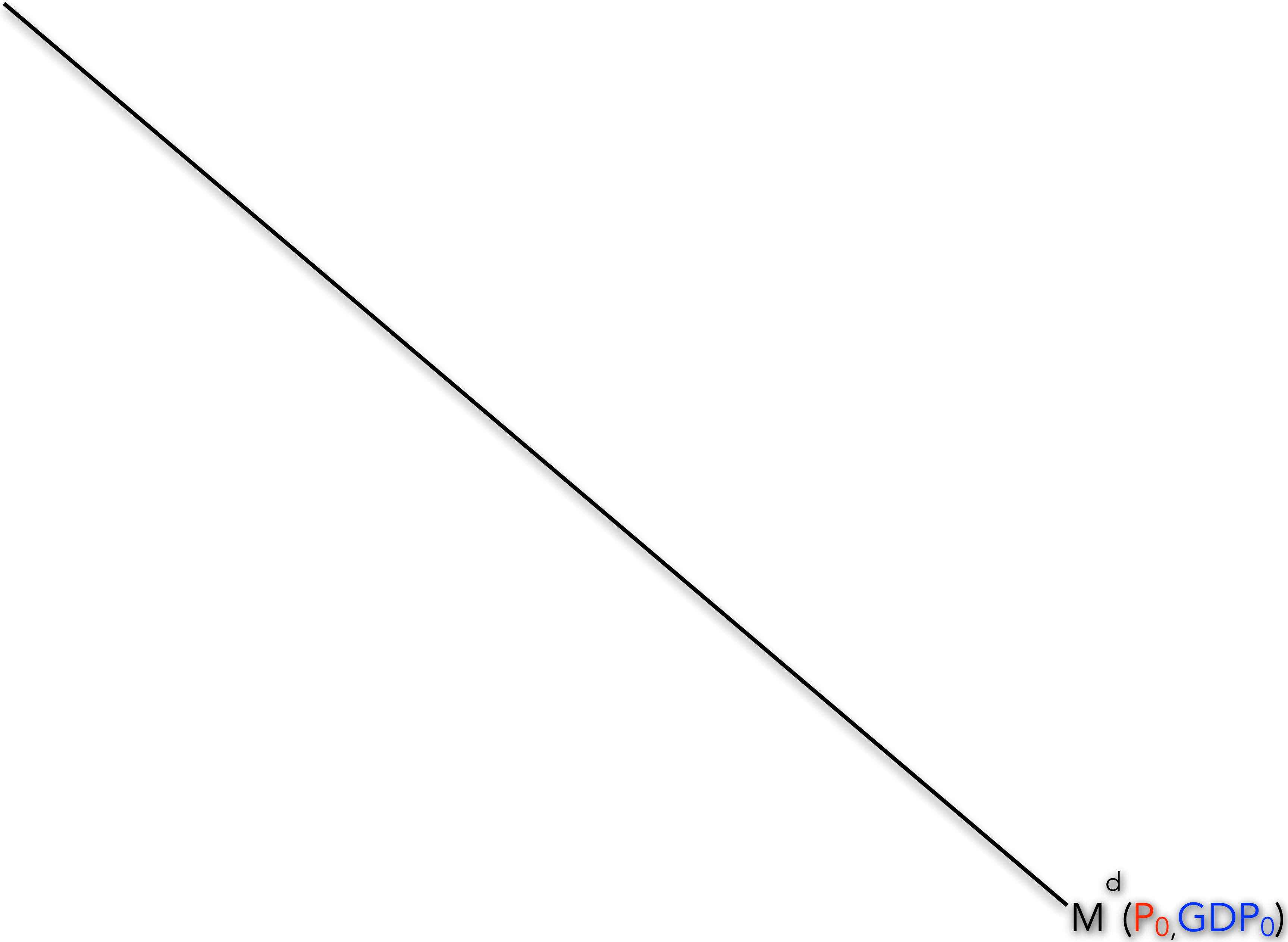
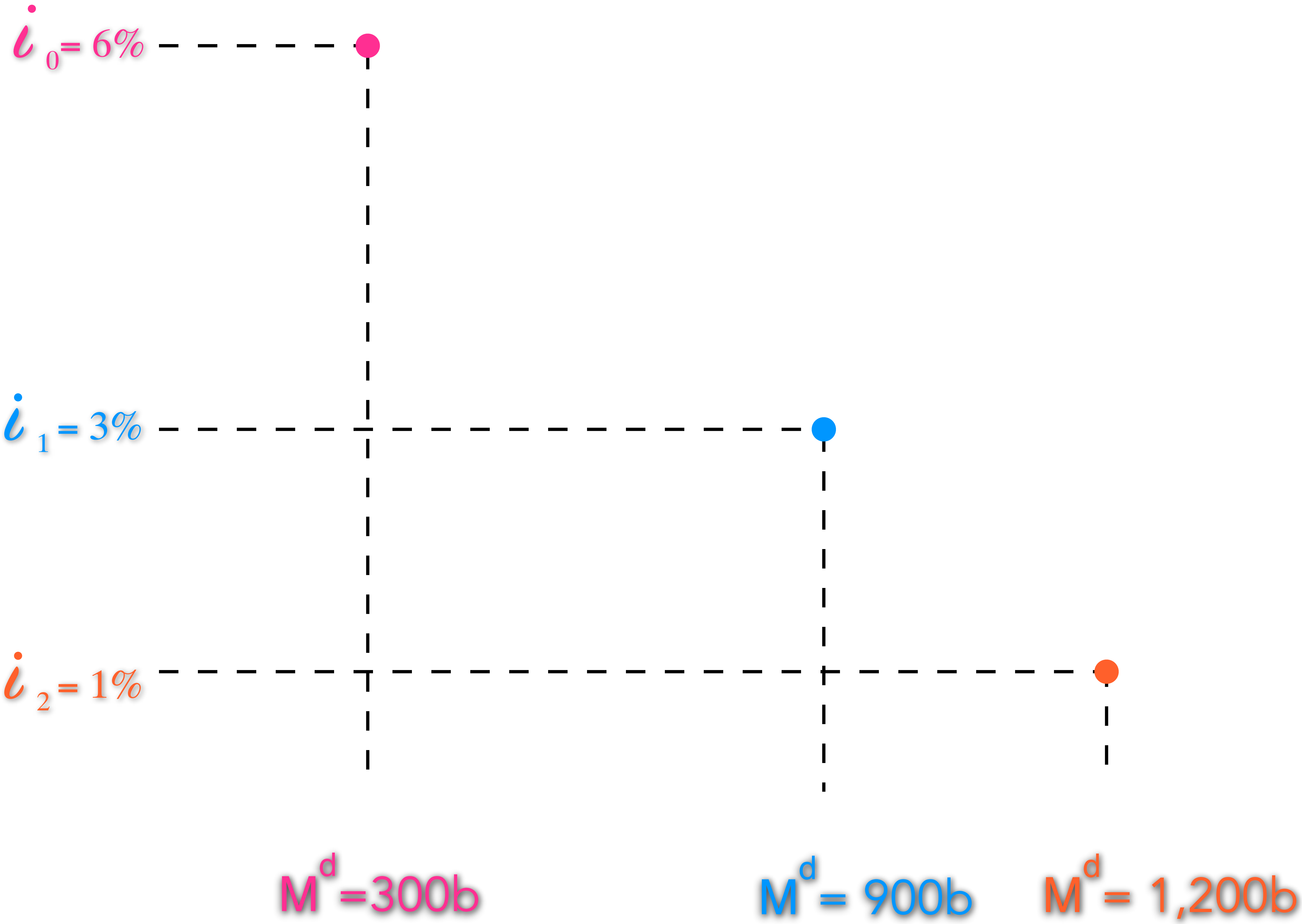
Currency+
Deposits

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 sells Bonds:

M^s shifts left

Reserves

Loans

Deposits

$$M^s \downarrow$$

M_1^s

$M^s = 300b$

Short of liquid balances

When there are shortages of liquid balances, money is scarce and there is pressure for the interest rate to rise

The interest rate will rise to a new equilibrium at 6%


New equilibrium

The Fed disappears reserves making money scarce at 3%

When the Fed sells bonds: Quantitative Tightening (QT)

The effect of a sale of bonds by the Fed

The effect of a sale of bonds by the Fed