





D = 250

$r = 10\%$

AR = RRR = 25

L

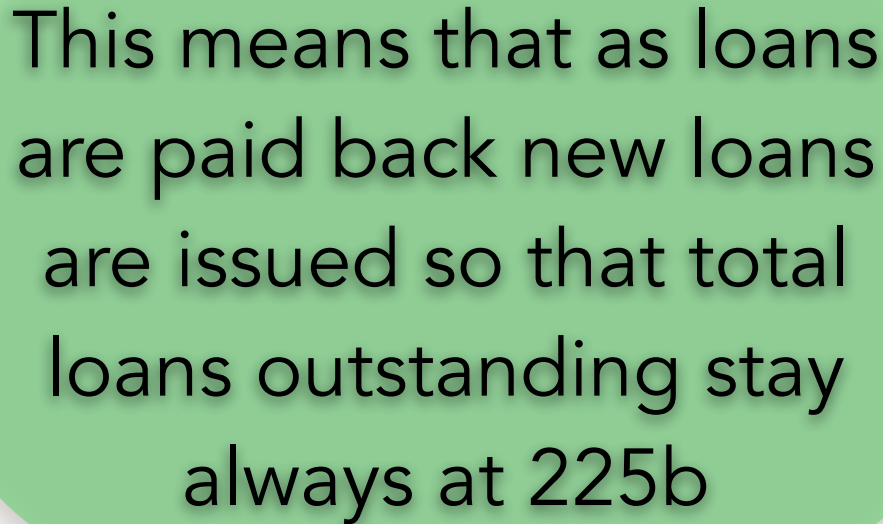
=

22

5

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



h



F



d



S

S

a









b







S

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2

S

e

b





h



D



p



S





S

a





R

e

S

e



V

e

S

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

RR=24.4

-6

-6

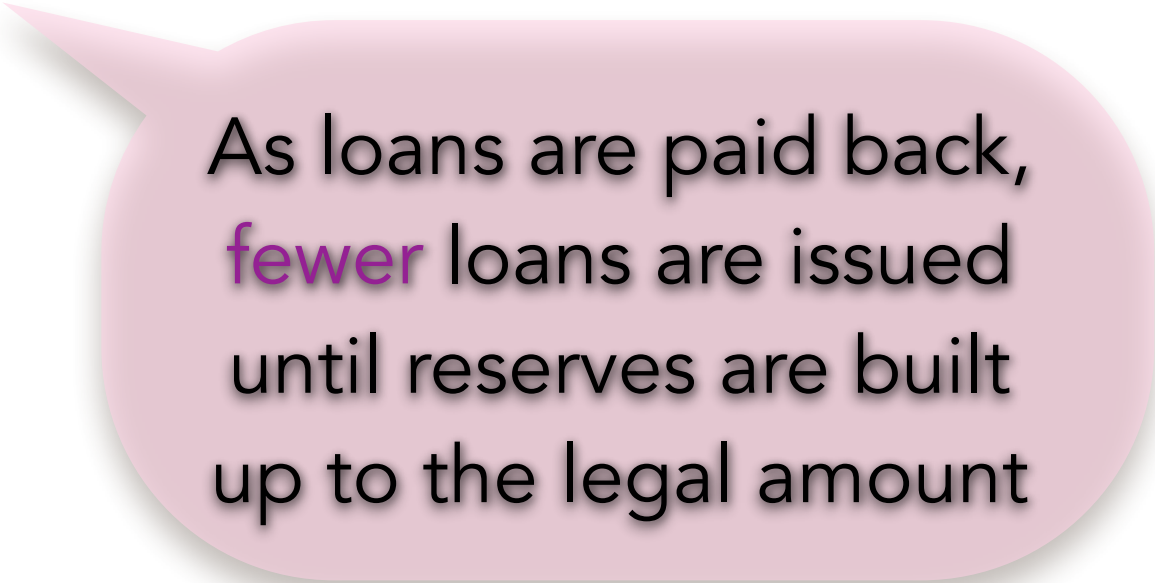
AR=19



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





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b

a







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

Bank A
 $r=10\%$

This is the drop for Bank A

The bank is now short of reserves

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	

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**