The Three Policy Instruments

- Open Market Operations
- Reserve Requirements
- Discount Window

An Open Market Operation

- The Fed wants to increase the money supply
- It goes into the open market and purchases (say) a $1,000 government bond, and pays for it with freshly printed money.

An Open Market Operation

- The Fed wants to decrease the money supply
- It goes into the open market and sells (say) a $1,000 government bond, takes a check in payment.
An Open Market Operation

Key Bank | Sam | Fed
---|---|---
A | L | A | L
Deposit at Fed: $1,000

Govt Bond: $100

Deposit by Key Bank: $1,000

The Government Buys a Bond

Key Bank | Sam | Fed
---|---|---
A | L | A | L
Deposit at Fed: $1,000

Govt Bond: $100

Key Deposit: $100

Deposit by Key Bank: $1,000

MB = $1,000
The Government Buys a Bond

Key Bank  Sam  Fed

A

L

Deposit at Fed: $1,100

Fred: $100

Key Deposit: $100

L

A

Deposit by Key Bank: $1,100

Key Deposit: $100

Fed

A

L

MB = $1,100

End

©2005 Charles W. Upton.  
All rights reserved