Open Market Operations

M_B

KENT STATE UNIVERSITY

The Three Policy Instruments

- **Open Market Operations**
- Reserve Requirements
- Discount Window

KENT STATE UNIVERSITY

An Open Market Operation

- The Fed wants to increase the money supply

KENT STATE UNIVERSITY

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.

KENT STATE UNIVERSITY

An Open Market Operation

- The Fed wants to decrease the money supply

KENT STATE UNIVERSITY

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..

KENT STATE UNIVERSITY

An Open Market Operation

Key Bank A	Key Bank L	Sam A	Sam L	Fed A	Fed L
Deposit at Fed: $1,000		Govt Bond: $100			Deposit by Key Bank: $1,000

An Open Market Operation

Key Bank A	Key Bank L	Sam A	Sam L	Fed A	Fed L
Deposit at Fed: $1,000		Govt Bond: $100			Deposit by Key Bank: $1,000

An Open Market Operation

Key Bank A	Key Bank L	Sam A	Sam L	Fed A	Fed L
Deposit at Fed: $1,000		Govt Bond: $100			Deposit by Key Bank: $1,000

An Open Market Operation

Key Bank A	Key Bank L	Sam A	Sam L	Fed A	Fed L
Deposit at Fed: $1,000		Govt Bond: $100			Deposit by Key Bank: $1,000

An Open Market Operation

Key Bank A	Key Bank L	Sam A	Sam L	Fed A	Fed L
Deposit at Fed: $1,000		Govt Bond: $100			Deposit by Key Bank: $1,000

M_B= $1,000

The Government Buys a Bond

Key Bank A	Key Bank L	Sam A	Sam L	Fed A	Fed L
Deposit at Fed: $1,000		~~Govt Bond: $100~~ Key Deposit $100			Deposit by Key Bank: $1,000

The Government Buys a Bond

Key Bank A	Key Bank L	Sam A	Sam L	Fed A	Fed L
Deposit at Fed: ~~$1,000~~ $1,100	**Fred: $100**	~~Govt Bond: $100~~ Key Deposit: $100			Deposit by Key Bank: ~~$1,000~~ $1,100

The Government Buys a Bond

Key Bank A	Key Bank L	Sam A	Sam L	Fed A	Fed L
Deposit at Fed: ~~$1,000~~ $1,100	**Fred: $100**	~~Govt Bond: $100~~ Key Deposit: $100			Deposit by Key Bank: ~~$1,000~~ $1,100

$M_B = \$1,100$

End