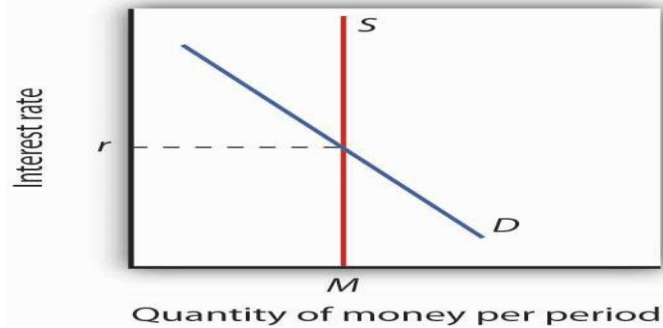


Question 82792

Use the money demand and money supply model to show graphically and explain the effect on nominal interest rates of the Federal Reserve's open market purchase of Treasury securities.

Answer In money demand and supply model, equilibrium interest rate is determined where demand curve intersect with the supply curve. Figure 1 explain the money market where r is the nominal interest rate and M is the money supply.

Figure 1



When Federal reserve's purchases treasury securities through open market operation that will increase the money supply in the economy and money supply curve will shift to the right from S_1 to S_2 and in result nominal interest rate will fall from r_1 to r_2 as explained in Figure 2.

Figure 2

