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## Interest on Reserves and Daylight Credit

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### Abstract

Payment of interest on banks' reserves has long been an important subject of discussion in monetary policy forums. Recent legislation that allows the U.S. Federal Reserve to pay interest on reserves starting in 2011 has made these issues especially timely. By studying a simple model of the demand for reserves by banks, one can better understand the alternative schemes available for implementing the payment of interest on reserves. This article's primary focus is to investigate the possible consequences that paying interest on overnight bank balances can have on the use of daylight credit by banks. By paying interest on reserves and supplying a large amount of reserves, the central bank can limit the use of daylight credit by depository institutions.

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