

U.S.

# Fed Watch

March 10, 2011

## Economic Analysis

**Hakan Danis**

hakan.danis@bbvacompass.com

**Jeffrey Owen Herzog**

jeff.herzog@bbvacompass.com

**Nathaniel Karp**

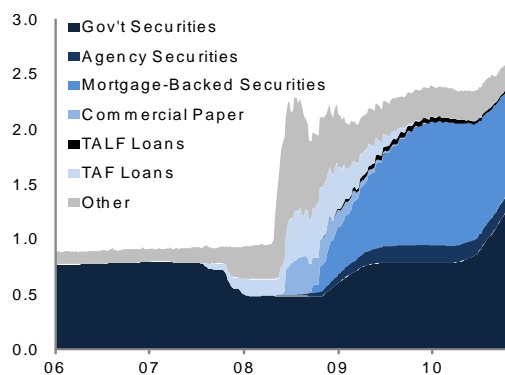
nathaniel.karp@bbvacompass.com

## Federal Reserve Balance Sheet New Record High Excess Reserves Pose Risk to Policy

Latest data on the Federal Reserve's balance sheet reveals that depository institutions are adding excess reserves at the fastest pace since the months surrounding the Lehman Brothers bankruptcy. According to today's data, reserve balances have increased by \$356bn since 5 January 2011, most of which occurred after February. Possible drivers for the rise in excess reserves may include recent increases in implied volatility and higher implied 5-year spot inflation rates. Interbank lending in recent weeks is around \$20bn lower than its level at the end of the year. Government securities purchases by commercial banks have been flat since the beginning of 2011 after a substantial rise of around \$200bn over the course of last year. At the same time, Federal Reserve Bank of New York Open Market Operations data suggests that the Fed has purchased \$418.5bn in securities as part of the current asset purchase program. The Fed is purchasing securities from the private sector, which is in turn adding to already-substantial excess reserve holdings instead of conducting long-term investments. This will make the exit strategy from extraordinary monetary policy increasingly difficult.

Chart 1

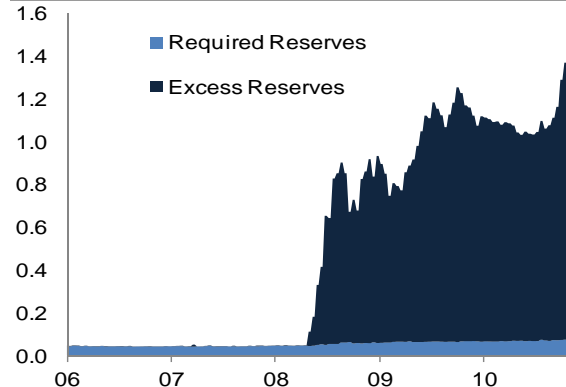
### Factors Supplying Reserve Funds (\$tr)



Source: BBVA Research and Federal Reserve

Chart 2

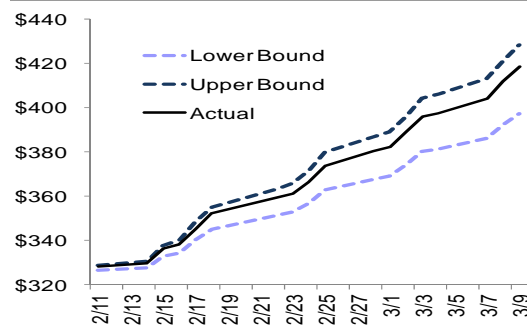
### Excess and Required Reserves (\$tr)



Source: BBVA Research and Federal Reserve

Chart 3

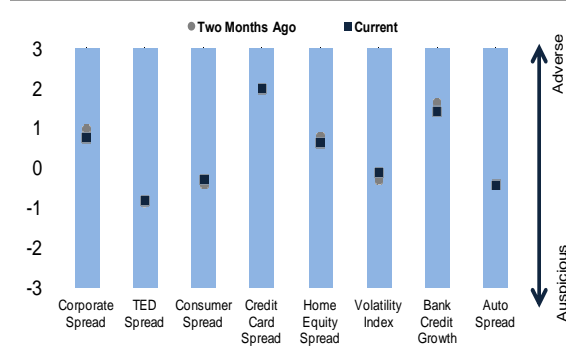
### Projected and Actual Fed Purchases



Source: BBVA Research and Federal Reserve

Chart 4

### Financial Indicators, Deviations from Mean



Source: BBVA Research and Bloomberg

## Disclaimer

This document was prepared by Banco Bilbao Vizcaya Argentaria's (BBVA) BBVA Research Department on behalf of itself and its affiliated companies (each BBVA Group Company) and is provided for information purposes only. The information, opinions, estimates and forecasts contained herein refer to the specific date and are subject to changes without notice due to market fluctuations. The information, opinions, estimates and forecasts contained in this document have been gathered or obtained from public sources believed to be correct by the Company concerning their accuracy, completeness, and/or correctness. This document is not an offer to sell or a solicitation to acquire or dispose of an interest in securities.