

U.S.

Fed Watch

March 31, 2011

Economic Analysis

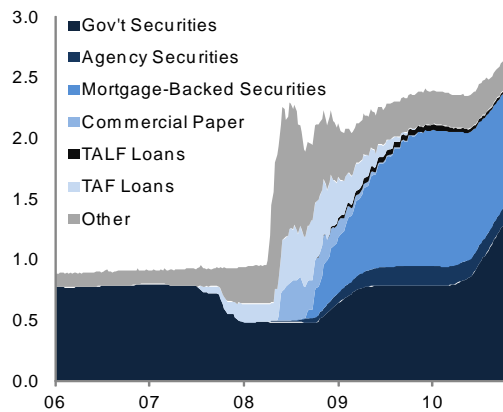
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Federal Reserve Balance Sheet Fed announces sale of subprime mortgage securities

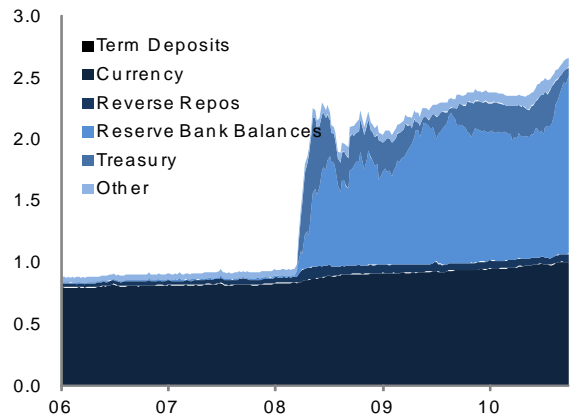
The Federal Reserve Bank of New York announced today the sale of around \$16bn Maiden Lane II assets via a competitive bidding process, a move that is expected to increase the drain rate of mortgage-backed securities (MBS) on the aggregate Fed balance sheet. This announcement arrives closely to the Treasury's 21 March statement that it would sell its \$142bn in MBS held since the financial crisis. Both MBS stocks are expected to be sold as financial conditions warrant, although the Maiden Lane II assets are primarily subprime mortgages opposed to the Treasury's agency-backed MBS. Excess reserves remain high compared to the beginning of the year, suggesting ample liquidity in the financial markets. Corporate spreads improved compared to two months ago, while bank credit crawls forward slowly along an improving trend. As we edge closer to an exit from extraordinary monetary policy, the Fed will be increasingly cognizant of market opportunities to offload legacy assets from its emergency crisis intervention programs.

Chart 1
Factors Supplying Reserve Funds (\$tr)



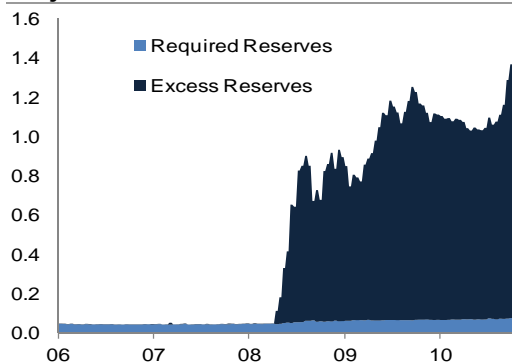
Source: BBVA Research and Federal Reserve

Chart 2
Factors Absorbing Reserve Funds (\$tr)



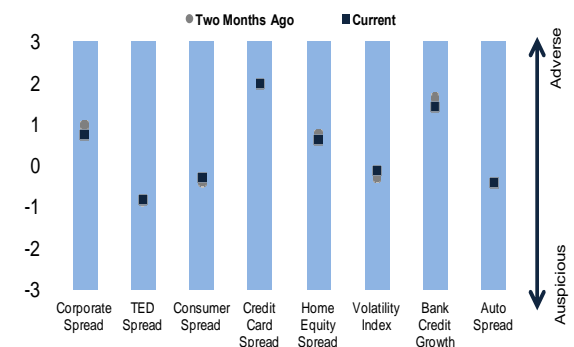
Source: BBVA Research and Federal Reserve

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

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