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Fed Watch

US

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Economic Analysis

US

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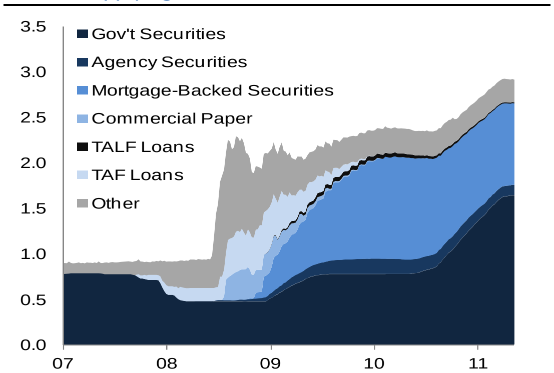
Federal Reserve Balance Sheet

Banks' reserves buildup enters a wait and see mode

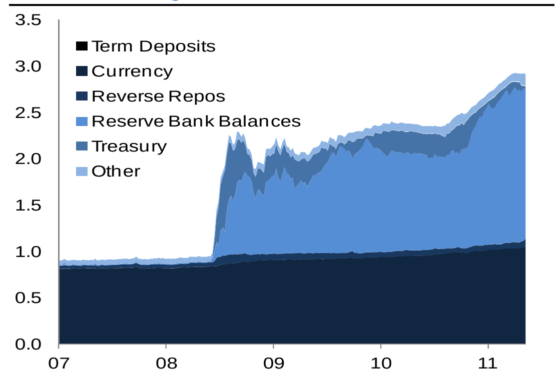
Excess reserves started the year at torrent pace, but declined 1.6% in the previous report and 0.4% in the current period, which suggests opposing market forces. On the one hand, the winding down of QE2 will slightly decrease market liquidity therefore making it less likely for depository institutions to increase their historically high excess reserves holdings. Conversely, current market volatility generally coincides with a flight to risk-free returns, which would induce firms to continue to expand depository holdings. The result was little to no change to excess reserve holdings. Furthermore, increased speculation surrounding QE3 could also increase the incentive to maintain a high level of reserves. In addition, excluding a jump in repurchase agreements, the Fed balance sheet has stabilized following its rapid expansion during QE2.

Chart 1
Factors Supplying Reserve Funds ($tr)



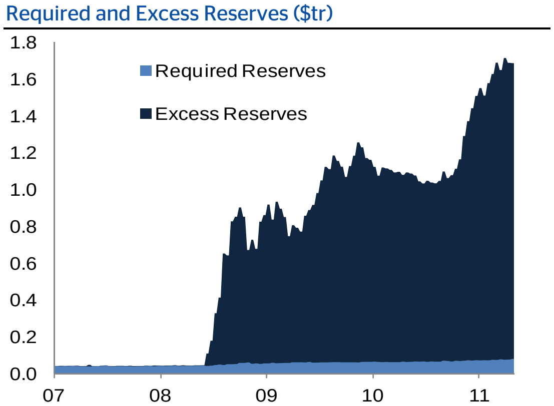
Source: Federal Reserve

Chart 2
Factors Absorbing Reserve Funds ($tr)



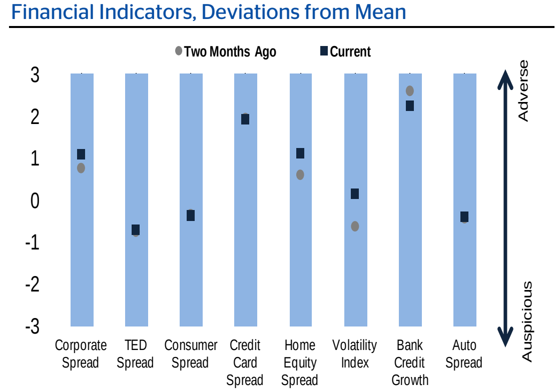
Source: Federal Reserve

Chart 3
Required and Excess Reserves ($tr)



Source: Federal Reserve

Chart 4
Financial Indicators, Deviations from Mean



Source: BBVA Research and Bloomberg