

Fed Watch

US

20 October 2011
Economic Analysis

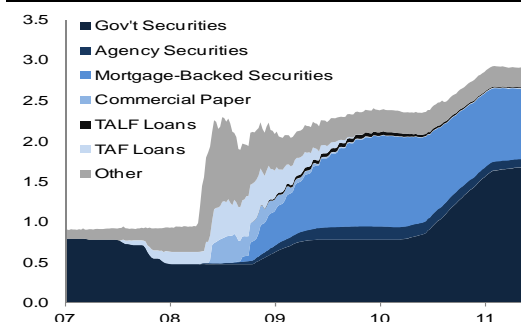
US

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Federal Reserve Balance Sheet Operation Un-Twist?

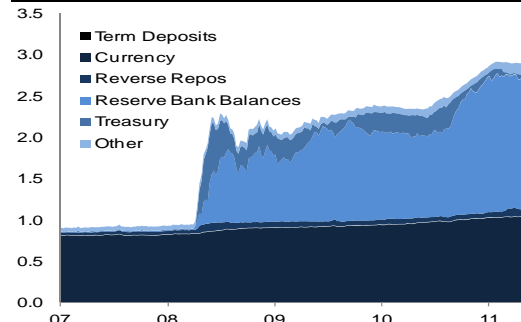
With all the excitement surrounding the Fed's attempt to stimulate the economy by increasing the average maturity of its holdings, the Fed's 15-day treasury holdings increased 65.1% WoW. Given that SOMA's mandate now includes maintaining short-term interest rates within the implicit 0-0.25% target while also pushing down on long-term interest rates, the WoW increase is not without cause. In terms of long-term holdings, the Fed continues to increase the portfolio's 5-10 yr and 10-30yr Treasury holdings, increasing 1.6% and 1.2% WoW respectively. Thus, short-term balance sheet dynamics suggest a flattening of the yield curve. Part of the Fed's recent announcement included plans to stimulate domestic demand in part by principal reinvestment of expiring Mortgage Backed Securities (MBS) in an attempt to influence mortgage rates and subsequently consumer's demand for homes. However, thus far the aggregate holdings of MBS declined 0.4% and 0.0% during the past two periods, respectively, and have declined or remained unchanged for 62 weeks. The Fed will also continue to monitor the effect of its operations on the functioning of short-term markets.

Chart 1
Factors Supplying Reserve Funds (\$tr)



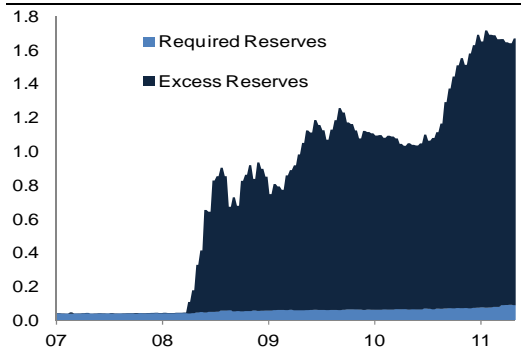
Source: Federal Reserve

Chart 2
Factors Absorbing Reserve Funds (\$tr)



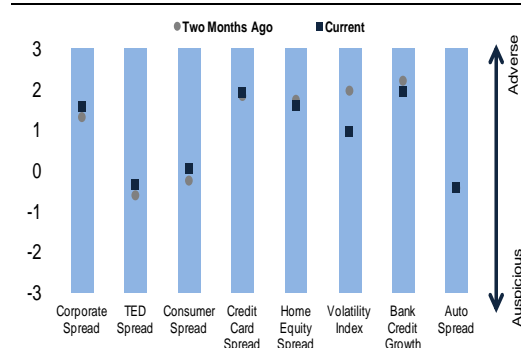
Source: Federal Reserve

Chart 3
Required and Excess Reserves (\$tr)



Source: Federal Reserve

Chart 4
Financial Indicators, Deviations from Mean



Source: BBVA Research and Bloomberg

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