

Fed Watch

9 December 2011 Economic Analysis

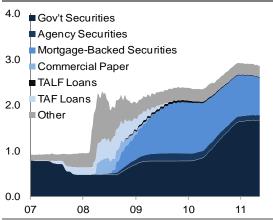
US

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Federal Reserve Balance Sheet Lifeline to Europe does not disrupt Operation Twist

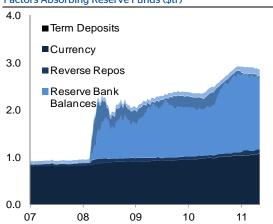
Last week the Fed announced that it would reduce the cost of dollar liquidity swap agreements, with a select group of central banks by 50bp. The move is an international monetary policy response to the European sovereign debt crisis and the subsequent spillover onto large European banks' balance sheet. However, the move, thus far, has not influenced domestic monetary policy objectives. For example, the slope of the yield curve has decreased by 3bp over the past two months alongside focused purchases of longer duration treasuries by the Fed. In doing so, the Fed also avoided balance sheet expansion as factors absorbing reserve funds have declined 0.7% over the same period. Excess reserves, on the other hand, have declined a \$173bn since the measure peaked in early July. It is unclear if the drop in excess reserves is a symptom of capital flight of European investors and even so, the recent move to increase international dollar liquidity should slow foreign outflows.

Factors Supplying Reserve Funds (\$tr)



Source: Federal Reserve

Chart 2 Factors Absorbing Reserve Funds (\$tr)



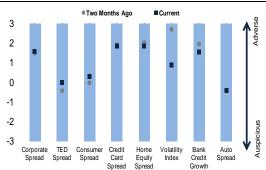
Source: Federal Reserve

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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