

U.S. Fed Watch

January 20, 2011

Economic Analysis

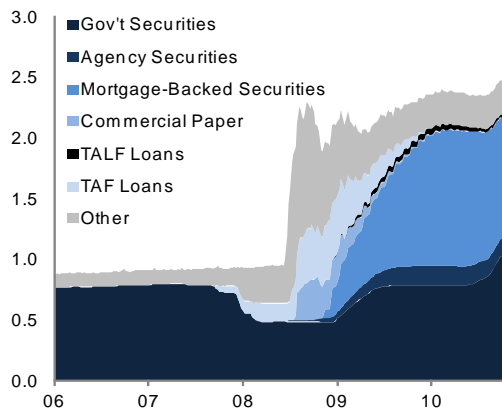
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Federal Reserve Balance Sheet AIG repayments reduce the size of the balance sheet

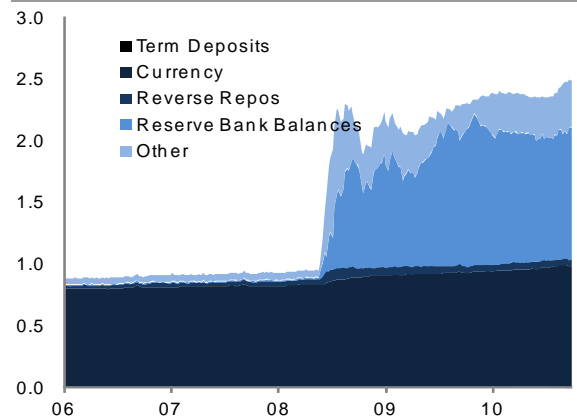
The Federal Reserve today announced that AIG's recapitalization would result in a termination of all funding commitments to the company, generating a roughly \$39.2bn gross reduction in the balance sheet. At the same time, the Federal Reserve continued with its reinvestment and large-scale asset purchase (LSAP) programs, having purchased some \$235.7bn in Treasury securities since November 10th. In the week ending January 19th, the Federal Reserve emphasized 5-10 year Treasuries by purchasing \$9.6bn of these securities. During the first two months, the sum total of Fed purchases arrived slightly below their projected total of \$105bn per month, but in the current third month of purchases the Fed plans to acquire \$112bn in securities. As such, the past two open market operations have tended towards the upper bound of projected purchases. Given the AIG repayments, the total balance sheet size decreased this month marginally to \$2.47tr, but this was expected ever since the AIG announcement. Selected financial indicators like the VIX and corporate spread are showing significant improvement over two months ago.

Chart 1
Factors Supplying Reserve Funds (\$tr)



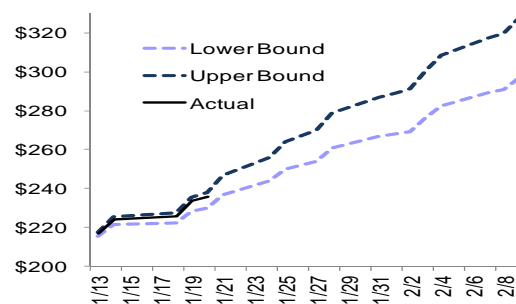
Source: BBVA Research and Federal Reserve

Chart 2
Factors Absorbing Reserve Funds (\$tr)



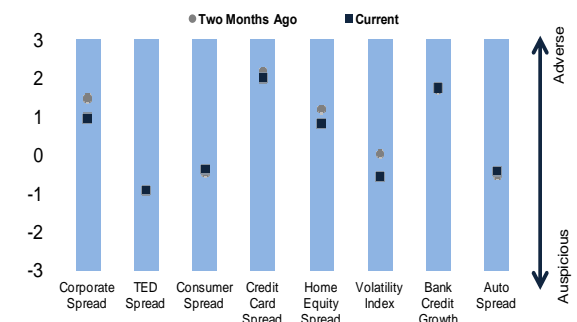
Source: BBVA Research and Federal Reserve

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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