

U.S.

Fed Watch

March 10, 2011

Economic Analysis

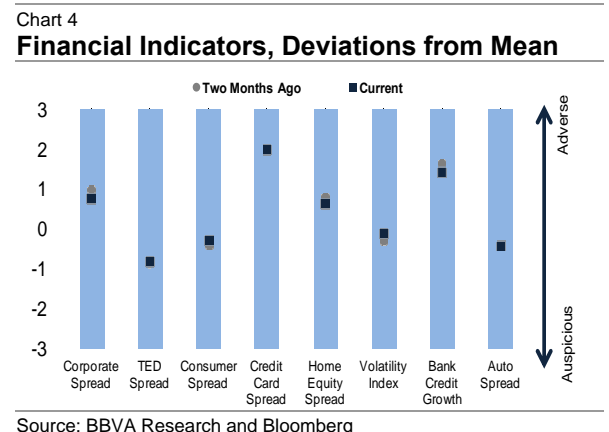
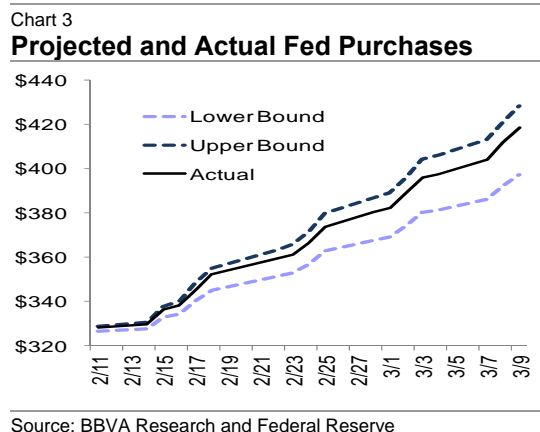
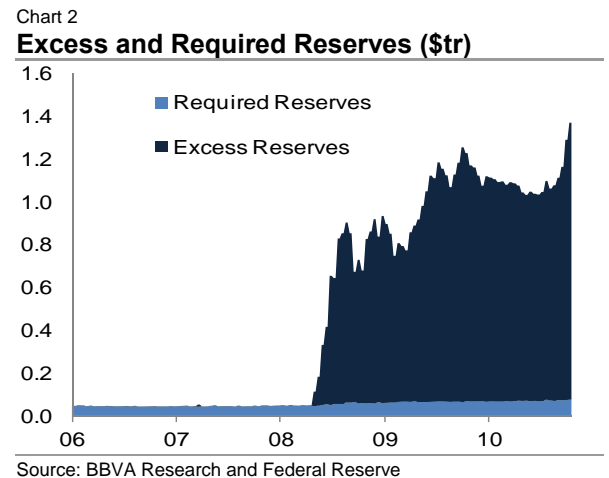
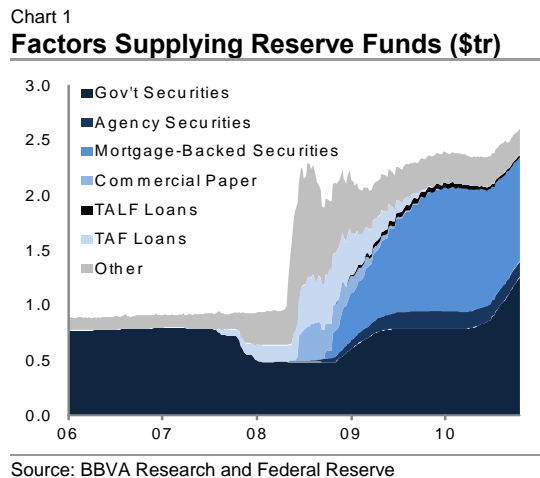
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Federal Reserve Balance Sheet New Record High Excess Reserves Pose Risk to Policy

Latest data on the Federal Reserve's balance sheet reveals that depository institutions are adding excess reserves at the fastest pace since the months surrounding the Lehman Brothers bankruptcy. According to today's data, reserve balances have increased by \$356bn since 5 January 2011, most of which occurred after February. Possible drivers for the rise in excess reserves may include recent increases in implied volatility and higher implied 5-year spot inflation rates. Interbank lending in recent weeks is around \$20bn lower than its level at the end of the year. Government securities purchases by commercial banks have been flat since the beginning of 2011 after a substantial rise of around \$200bn over the course of last year. At the same time, Federal Reserve Bank of New York Open Market Operations data suggests that the Fed has purchased \$418.5bn in securities as part of the current asset purchase program. The Fed is purchasing securities from the private sector, which is in turn adding to already-substantial excess reserve holdings instead of conducting long-term investments. This will make the exit strategy from extraordinary monetary policy increasingly difficult.



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