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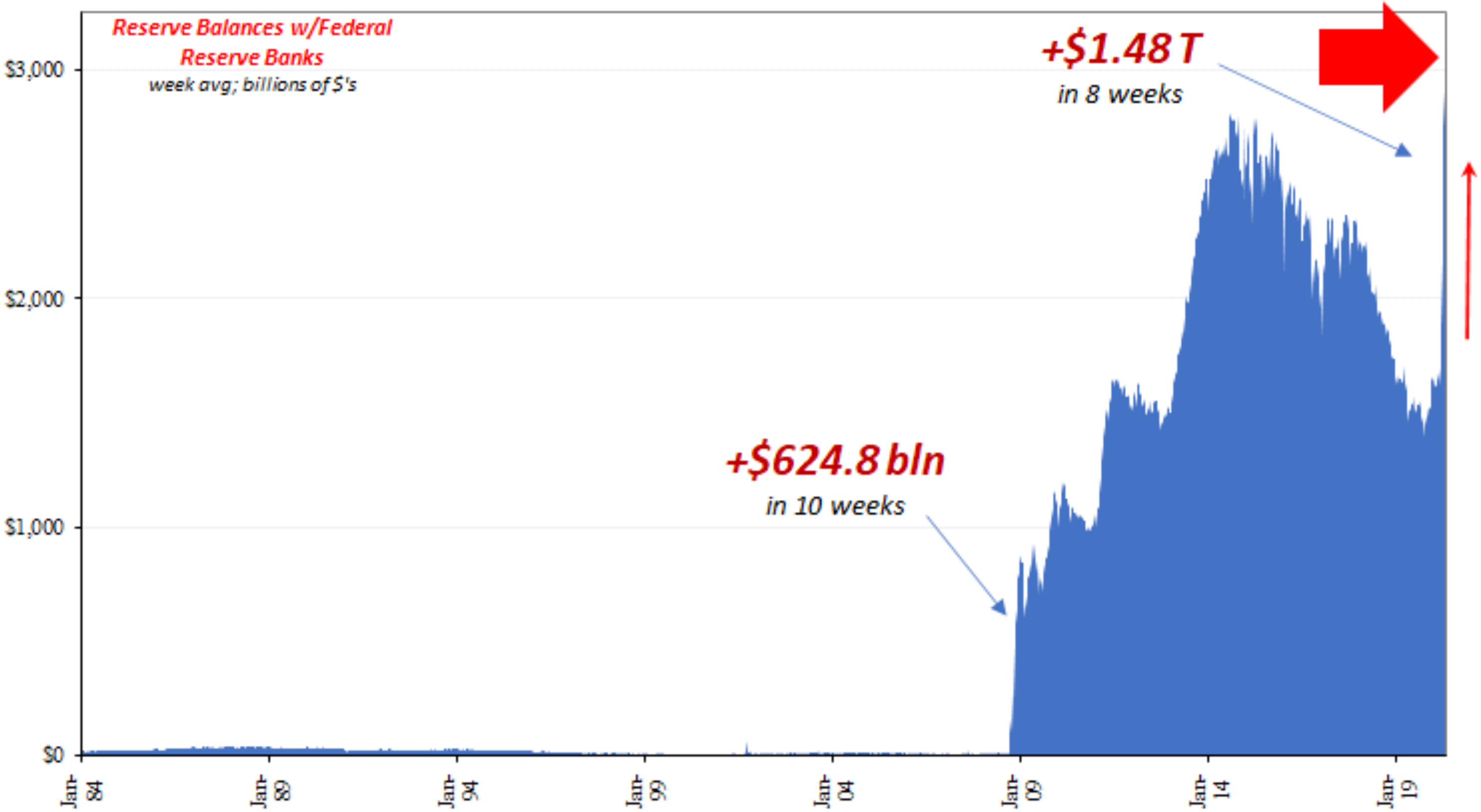
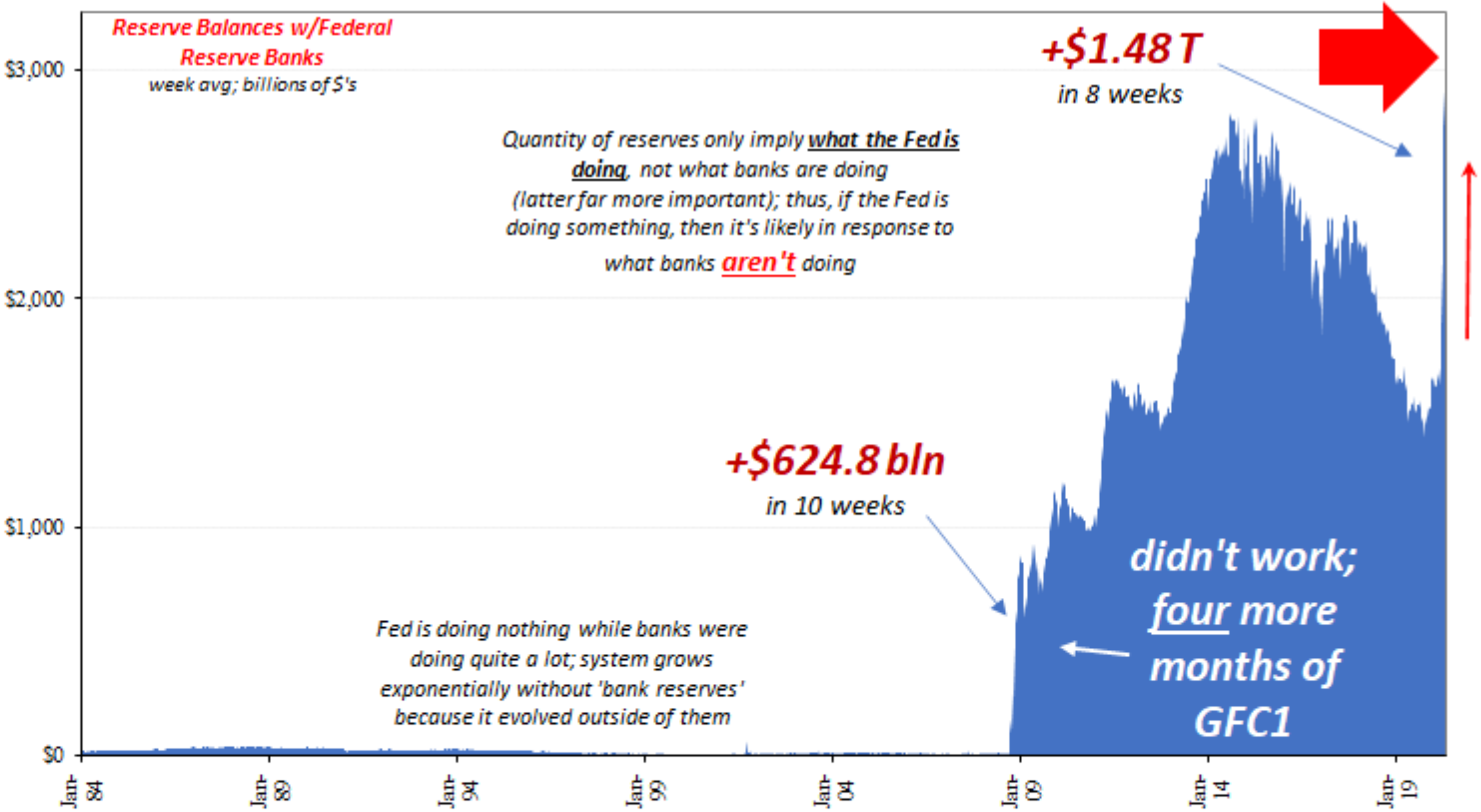
GFC2: The Bowl's Empty

(Eurodollar University)

Federal Reserve: Liabilities & Capital



Federal Reserve: Liabilities & Capital



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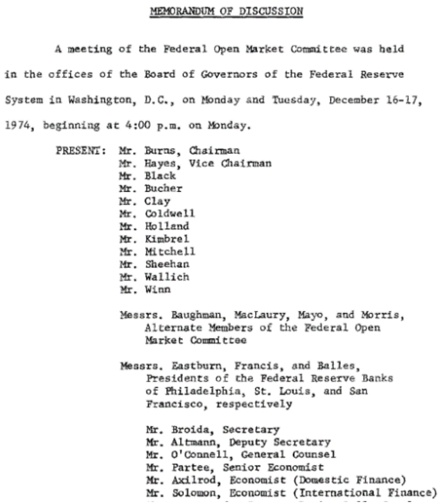
“In reply, Mr. Coombs said an effort could be made to develop such a measure, but he doubted that it would be successful. The volume of funds which might be shifted back and forth between the of the monetary statistics arose in connection with Euro-dollars; he suspected that **at least some part of the Euro-dollar-based money supply** should be included in the U.S. money supply. More generally, he thought **M1 was becoming increasingly obsolete as a monetary indicator**. The Committee should be focusing more on M2, and it should be moving toward some new version of M3--especially because of the participation of nonbank thrift institutions in money transfer activities.

FOMC
Memorandum of Discussion
December 1974


MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Monday and Tuesday, December 16-17, 1974, beginning at 4:00 p.m. on Monday.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Black
Mr. Bucher
Mr. Clay
Mr. Coldwell
Mr. Holland
Mr. Kimbrel
Mr. Mitchell
Mr. Sheehan
Mr. Wallich
Mr. Winn

Messrs. Baughman, MacLaury, Mayo, and Morris, Alternate Members of the Federal Open Market Committee

Messrs. Eastburn, Francis, and Balles, Presidents of the Federal Reserve Banks of Philadelphia, St. Louis, and San Francisco, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. O'Connell, General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Mr. Solomon, Economist (International Finance)

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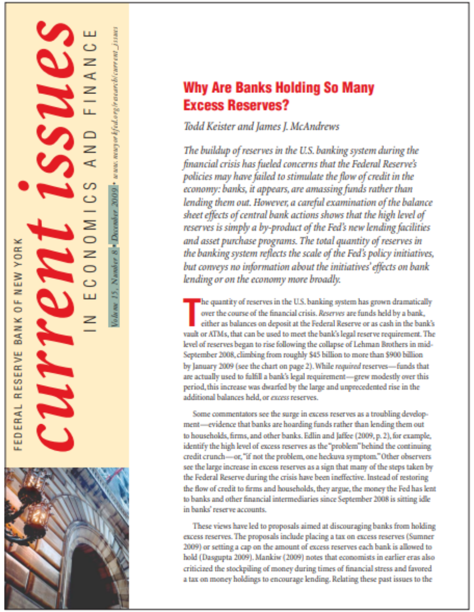
FEDERAL RESERVE BANK OF NEW YORK

current issues

IN ECONOMICS AND FINANCE

Volume 15, Number 8 • December 2009 • www.newyorkfed.org/research/current_issues

Why Are Banks Holding So Many Excess Reserves?

Todd Keister and James J. McAndrews

The buildup of reserves in the U.S. banking system during the financial crisis has fueled concerns that the Federal Reserve's policies may have failed to stimulate the flow of credit in the economy: banks, it appears, are amassing funds rather than lending them out. However, a careful examination of the balance sheet effects of central bank actions shows that the high level of reserves is simply a by-product of the Fed's new lending facilities and asset purchase programs. The total quantity of reserves in the banking system reflects the scale of the Fed's policy initiatives, but conveys no information about the initiatives' effects on bank lending or on the economy more broadly.

The quantity of reserves in the U.S. banking system has grown dramatically over the course of the financial crisis. *Reserves* are funds held by a bank, either as balances on deposit at the Federal Reserve or as cash in the bank's vault or ATMs, that can be used to meet the bank's legal reserve requirement. The level of reserves began to rise following the collapse of Lehman Brothers in mid-September 2008, climbing from roughly $45 billion to more than $900 billion by January 2009 (see the chart on page 2). While *required* reserves—funds that are actually used to fulfill a bank's legal requirement—grew modestly over this period, this increase was dwarfed by the large and unprecedented rise in the additional balances held, or *excess* reserves.

Some commentators see the surge in excess reserves as a troubling development—evidence that banks are hoarding funds rather than lending them out to households, firms, and other banks. Edlin and Jaffee (2009, p. 2), for example, identify the high level of excess reserves as the "problem" behind the continuing credit crunch—or, "if not the problem, one heckuva symptom." Other observers see the large increase in excess reserves as a sign that many of the steps taken by the Federal Reserve during the crisis have been ineffective. Instead of restoring the flow of credit to firms and households, they argue, the money the Fed has lent to banks and other financial intermediaries since September 2008 is sitting idle in banks' reserve accounts.

These views have led to proposals aimed at discouraging banks from holding excess reserves. The proposals include placing a tax on excess reserves (Sumner 2009) or setting a cap on the amount of excess reserves each bank is allowed to hold (Dasgupta 2009). Mankiw (2009) notes that economists in earlier eras also criticized the stockpiling of money during times of financial stress and favored a tax on money holdings to encourage lending. Relating these past issues to the

"First, we showed that the liquidity facilities and other credit programs introduced by the Federal Reserve in response to the crisis have created, **as a by-product, a large quantity of reserves** in the banking system. Second, we showed that while the lending decisions and other activities of banks may result in small changes in the level of required reserves, the vast majority of the newly created reserves will end up being held as excess reserves. **The dramatic buildup of excess reserves reflects the large scale of the Federal Reserve's policy initiatives; it conveys no information about the effects of these initiatives on bank lending or on the level of economic activity**.

Todd Keister and James J. McAndrews
Why Are Banks Holding So Many Excess Reserves?
FRBNY Current Issues
Volume 15, Number 8; December 2009

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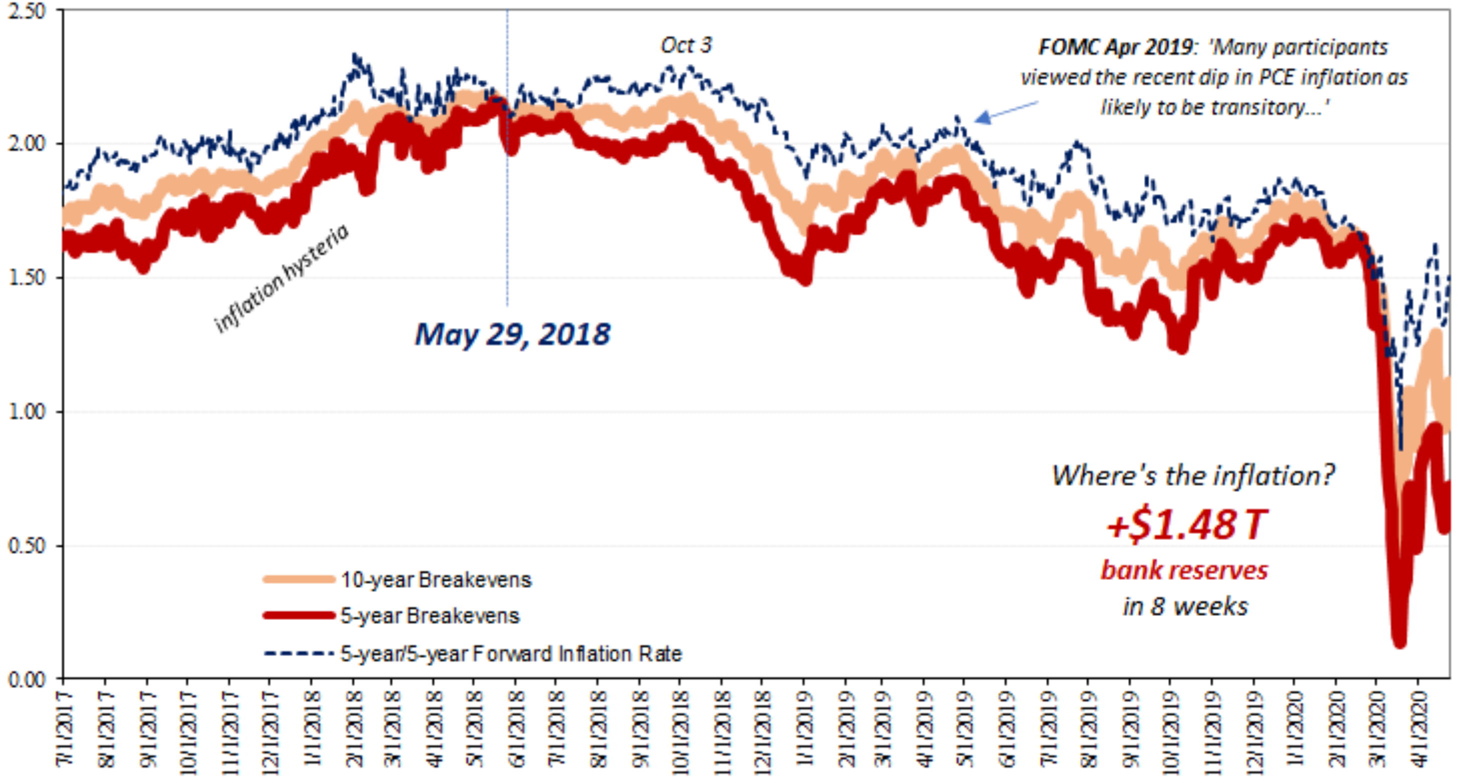
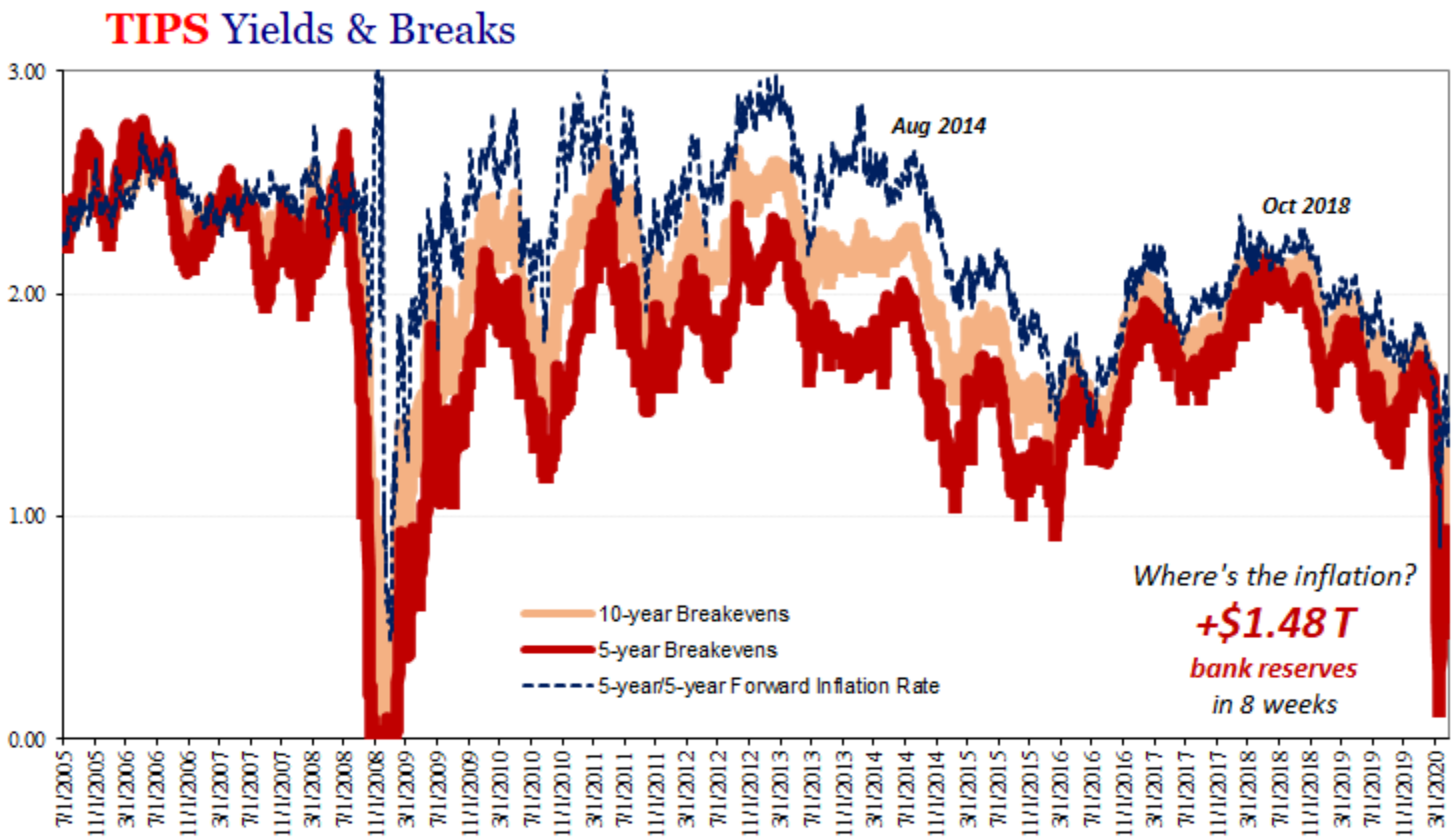
“ This is how you should view the Fed’s balance sheet from the most charitable point of view. The central bank isn’t adding more money to a static system already filled with it; like our engine analogy, **Jay Powell is frantically trying to replace what has already leaked out**. The more he puts in, **the more the balance sheet is expanded, the more you know must’ve gone missing**.

It’s a **warning**, not a solution.

Alhambra Investments
The Global Engine Is Still Leaking
April 13, 2020

TIPS Yields & Breaks




TIPS Yields & Breaks
3.00
2.00
1.00
0.00
Aug 2014
Oct 2018
Where's the inflation?
+$1.48 T
bank reserves
in 8 weeks
10-year Breakevens
5-year Breakevens
5-year/5-year Forward Inflation Rate
7/1/2005
11/1/2005
3/1/2006
7/1/2006
11/1/2006
3/1/2007
7/1/2007
11/1/2007
3/1/2008
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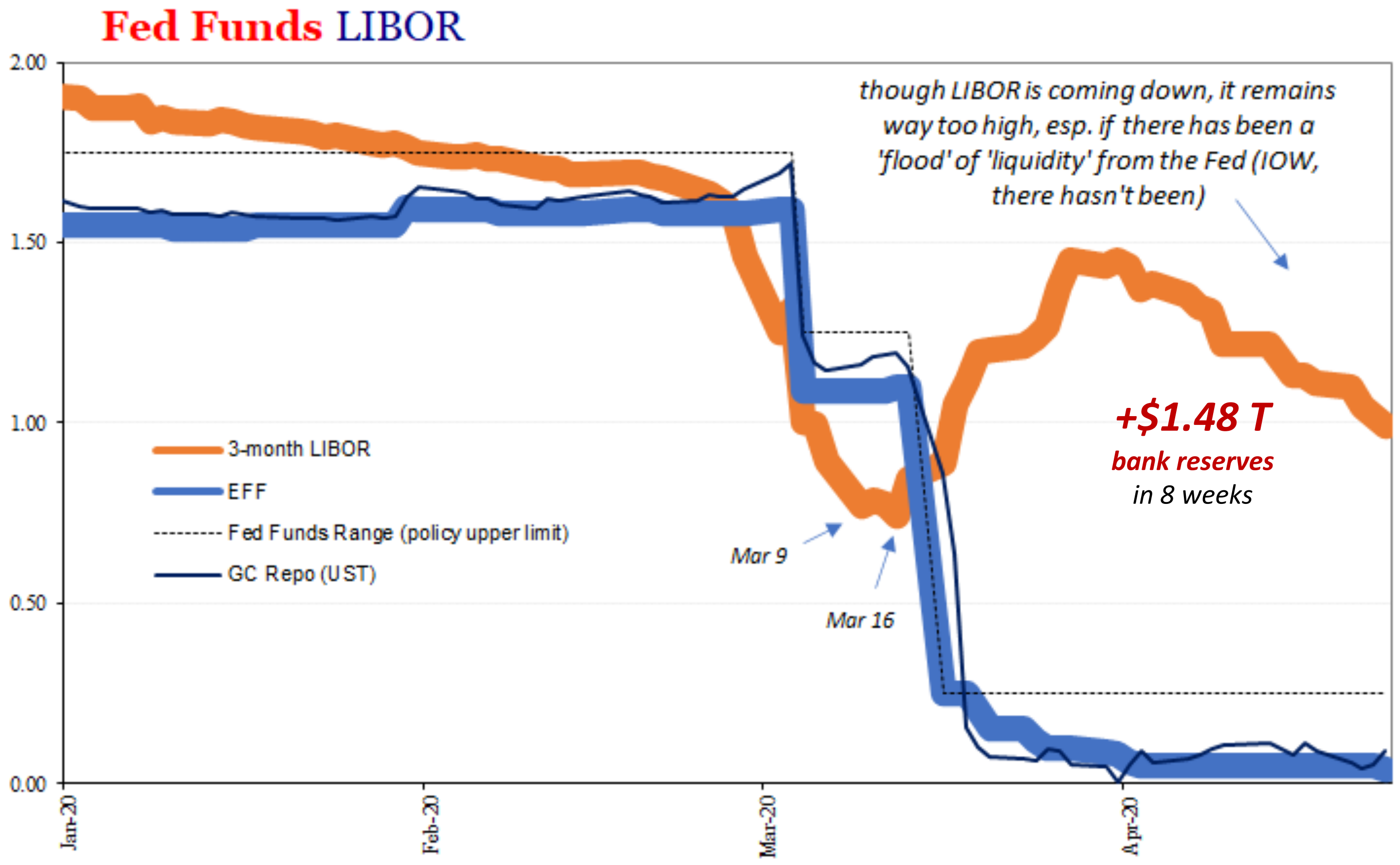
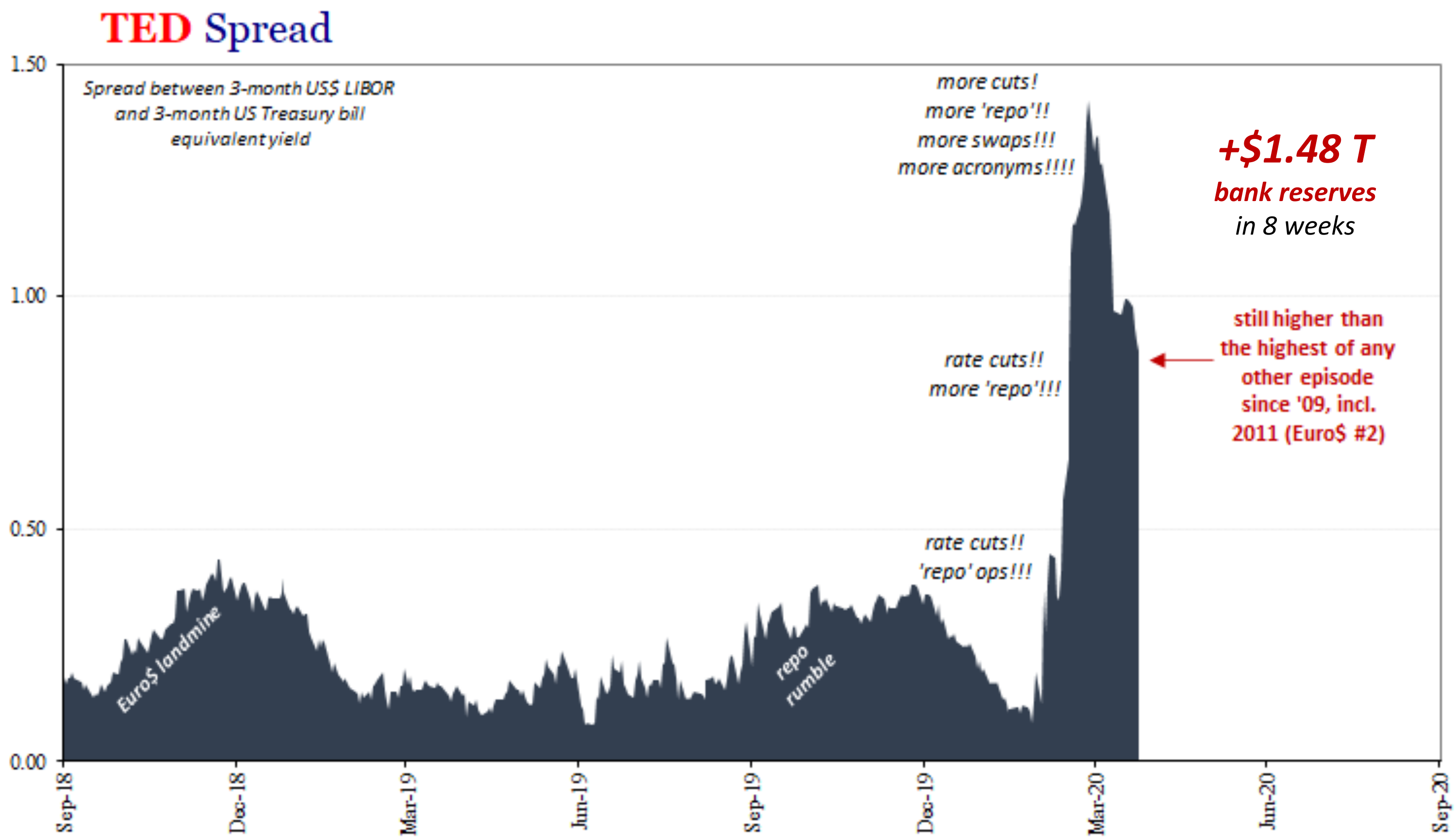
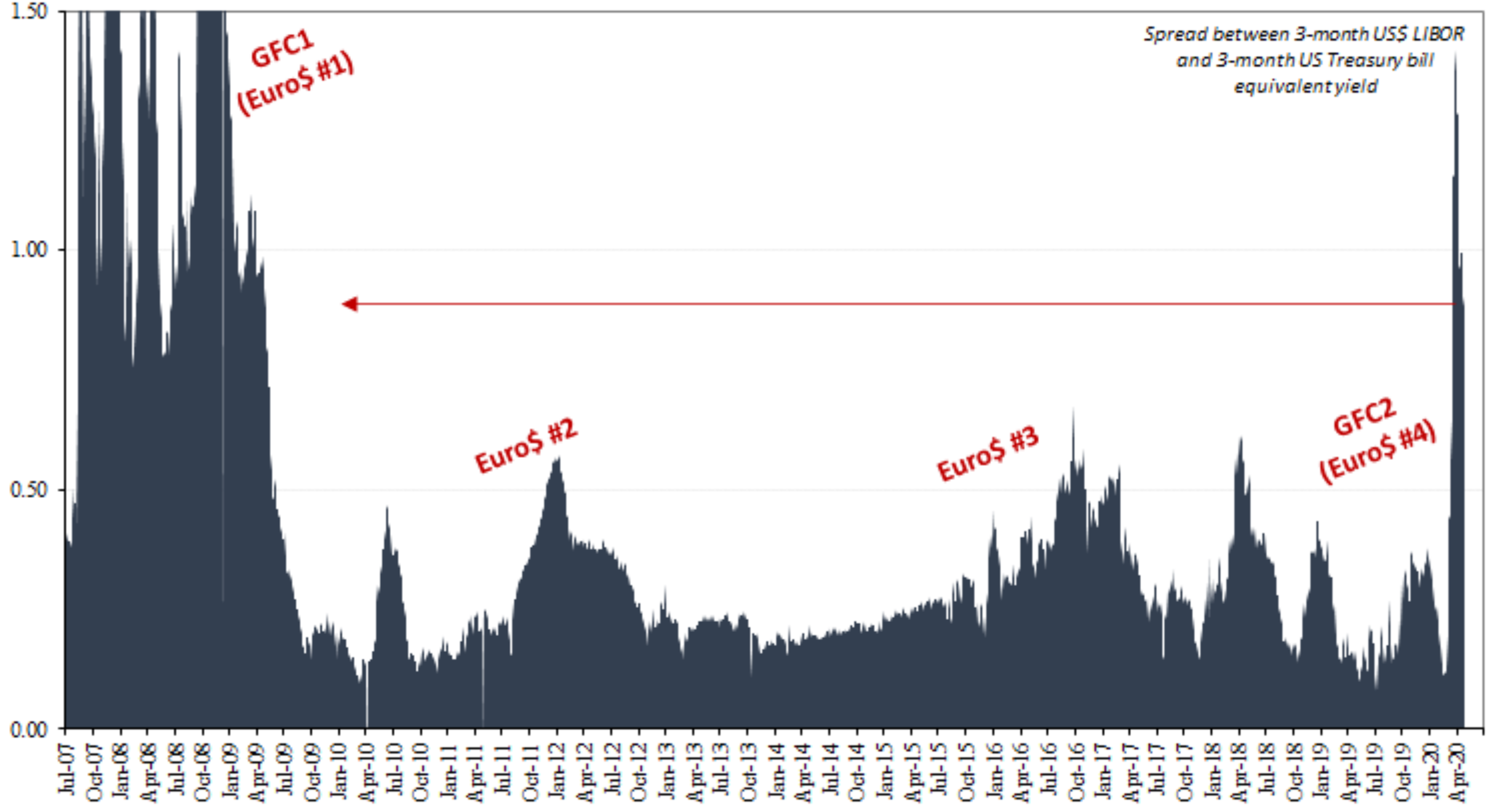
11/1/2019
3/1/2020


Fed Funds LIBOR
2.00
1.50
1.00
0.50
0.00
Jan-20
Feb-20
Mar-20
Apr-20
3-month LIBOR
EFF
Fed Funds Range (policy upper limit)
GC Repo (UST)
though LIBOR is coming down, it remains way too high, esp. if there has been a 'flood' of 'liquidity' from the Fed (IOW, there hasn't been)
Mar 9
Mar 16
+$1.48 T
bank reserves
in 8 weeks


TED Spread
Spread between 3-month US$ LIBOR
and 3-month US Treasury bill
equivalent yield
1.50
1.00
0.50
0.00
Sep-18
Dec-18
Mar-19
Jun-19
Sep-19
Dec-19
Mar-20
Jun-20
Sep-20
Euro$ landmine
repo
rumble
rate cuts!!
'repo' ops!!!
rate cuts!!
more 'repo'!!!
more cuts!
more 'repo'!!
more swaps!!!
more acronyms!!!!
+$1.48 T
bank reserves
in 8 weeks
still higher than
the highest of any
other episode
since '09, incl.
2011 (Euro$ #2)

TED Spread


1.50
1.00
0.50
0.00
GFC1 (Euro$ #1)
Euro$ #2
Euro$ #3
GFC2 (Euro$ #4)
Spread between 3-month US$ LIBOR and 3-month US Treasury bill equivalent yield
Jul-07
Oct-07
Jan-08
Apr-08
Jul-08
Oct-08
Jan-09
Apr-09
Jul-09
Oct-09
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Oct-10
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Jan-20
Apr-20

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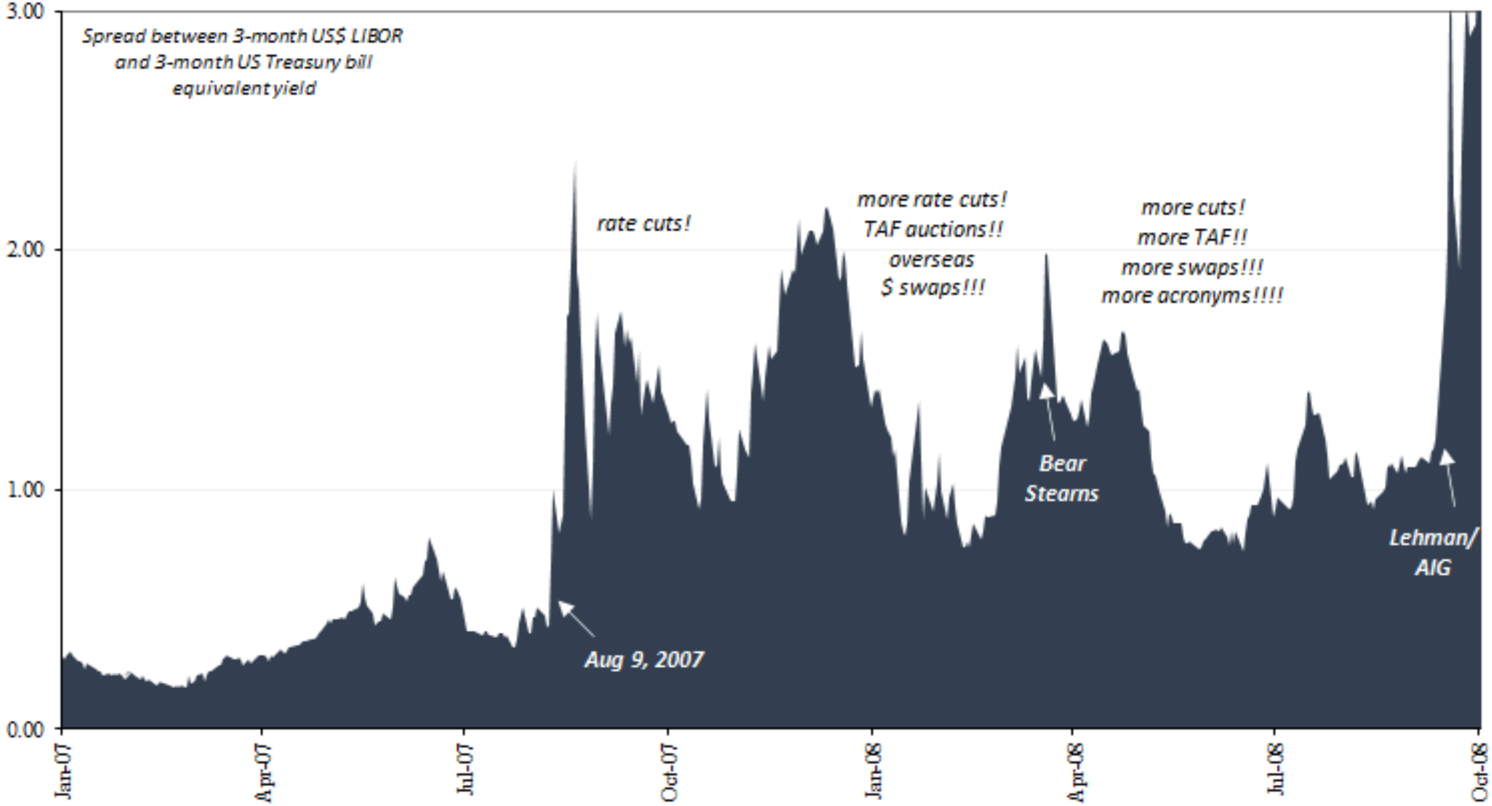
TED Spread



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"MR. BULLARD. There is, to be sure, still some potential for additional upheaval, depending in part on the managerial agility among key financial firms. However, the U.S. economy is now much better positioned to handle financial market turmoil than it was six months ago. **This is due to the lending facilities now in place** and to the environment of low interest rates that has been created**. Renewed financial market turmoil, should it occur during the summer or fall, would not now be as worrisome from a systemic risk perspective.**

June 24–25, 2008 1 of 253

Meeting of the Federal Open Market Committee on June 24–25, 2008

A joint meeting of the Federal Open Market Committee and Board of Governors of the Federal Reserve System was held in the offices of the Board of Governors in Washington, D.C., on Tuesday, June 24, 2008, at 2:00 p.m., and continued on Wednesday, June 25, 2008, at 9:00 a.m. Those present were the following:

Mr. Bernanke, Chairman
Mr. Geithner, Vice Chairman
Mr. Fisher
Mr. Kohn
Mr. Kroszner
Mr. Mishkin
Ms. Pianalto
Mr. Plosser
Mr. Stern
Mr. Warsh

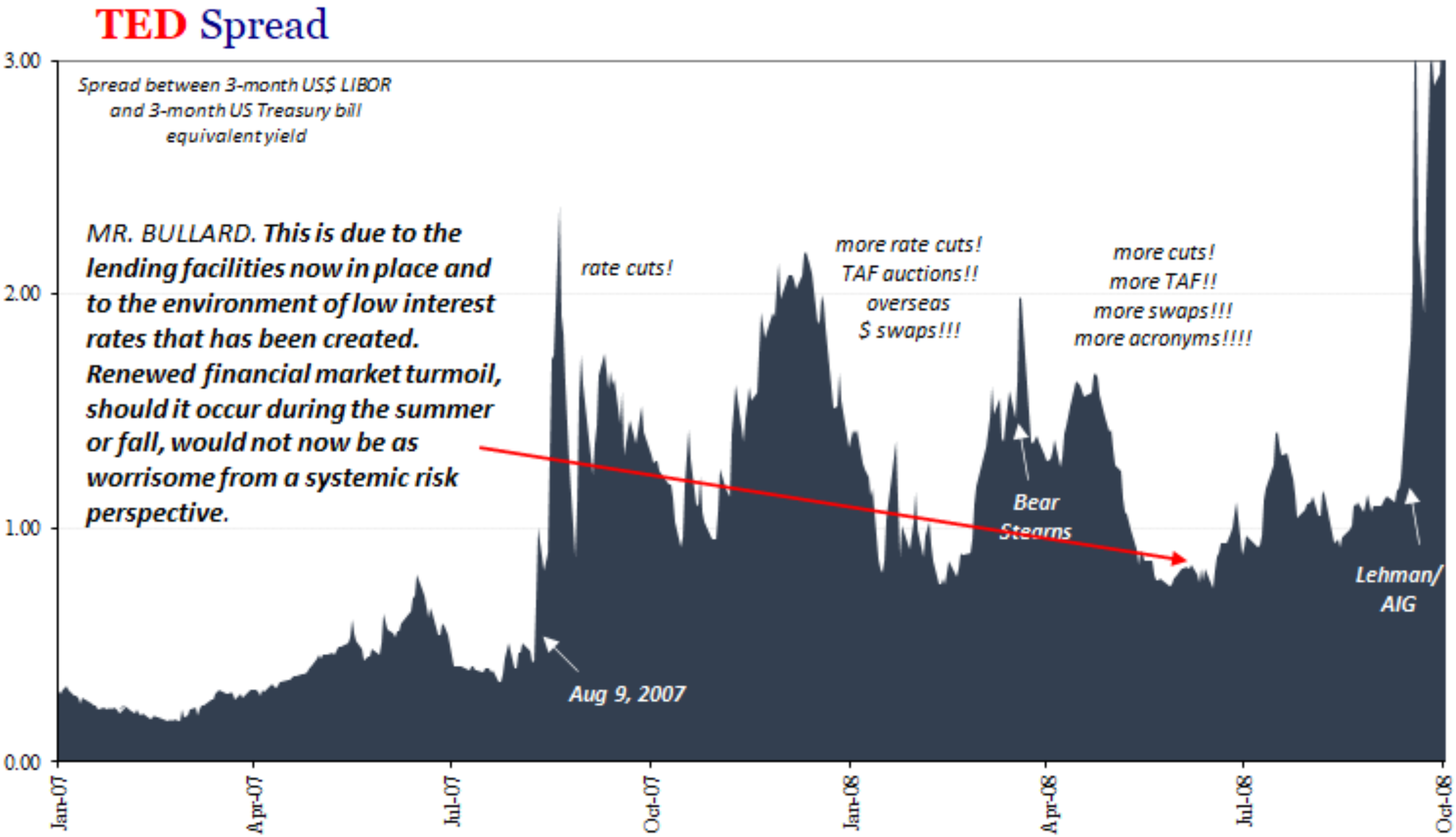
Ms. Cumming, Messrs. Evans, Lacker, and Lockhart, and Ms. Yellen, Alternate Members of the Federal Open Market Committee

Messrs. Bullard, Hoenig, and Rosengren, Presidents of the Federal Reserve Banks of St. Louis, Kansas City, and Boston, respectively

Mr. Madigan, Secretary and Economist
Ms. Danker, Deputy Secretary
Mr. Skidmore, Assistant Secretary
Ms. Smith, Assistant Secretary
Mr. Alvarez, General Counsel
Mr. Baxter, Deputy General Counsel

FOMC Meeting Transcript

June 24-25, 2008


TED Spread
Spread between 3-month US$ LIBOR and 3-month US Treasury bill equivalent yield
MR. BULLARD. This is due to the lending facilities now in place and to the environment of low interest rates that has been created. Renewed financial market turmoil, should it occur during the summer or fall, would not now be as worrisome from a systemic risk perspective.
rate cuts!
more rate cuts!
TAF auctions!!
overseas
$ swaps!!!
more cuts!
more TAF!!
more swaps!!!
more acronyms!!!!
Bear Stearns
Lehman/ AIG
Aug 9, 2007
3.00
2.00
1.00
0.00
Jan-07
Apr-07
Jul-07
Oct-07
Jan-08
Apr-08
Jul-08
Oct-08

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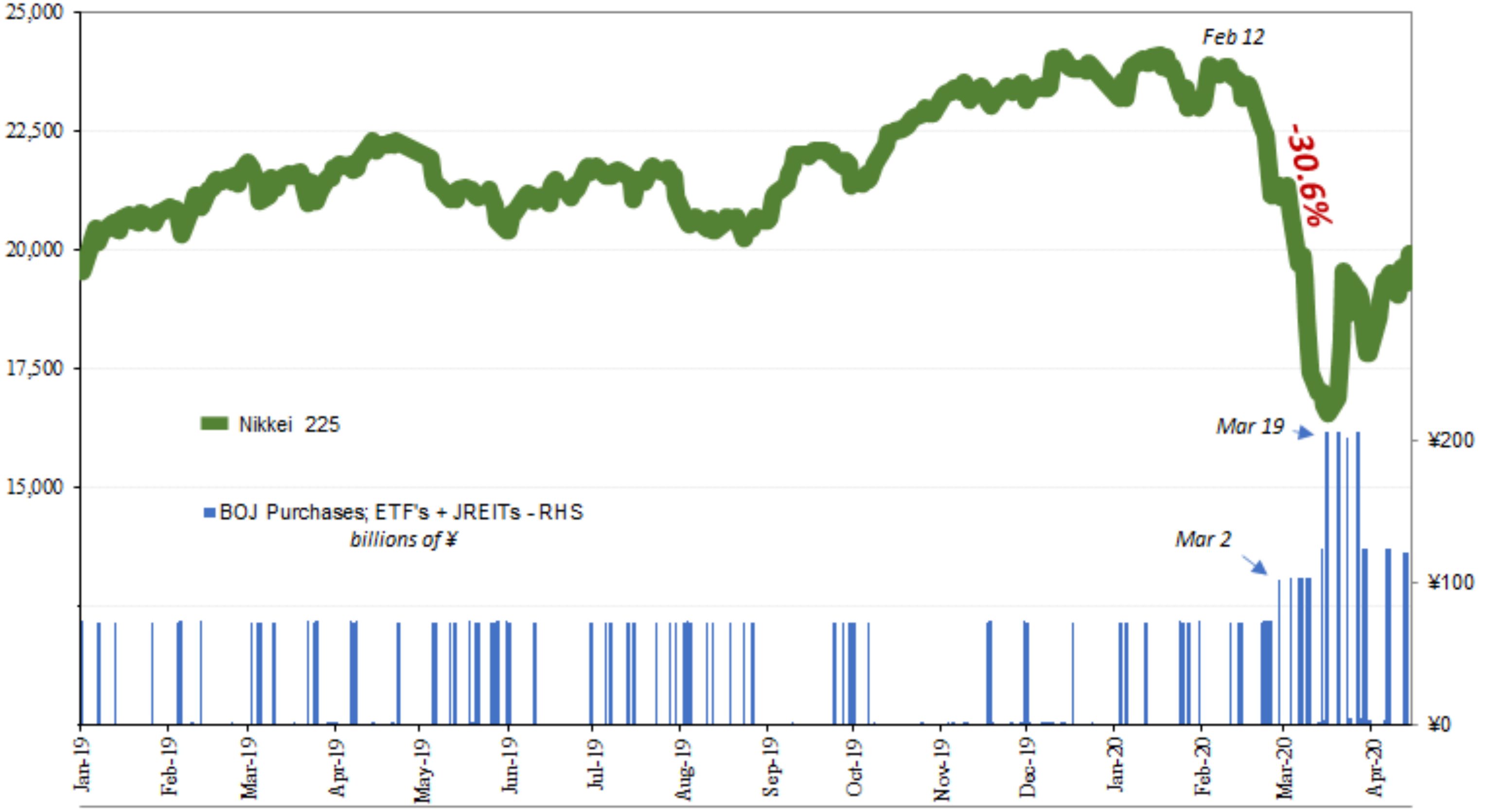
Nikkei 225 Stock Index



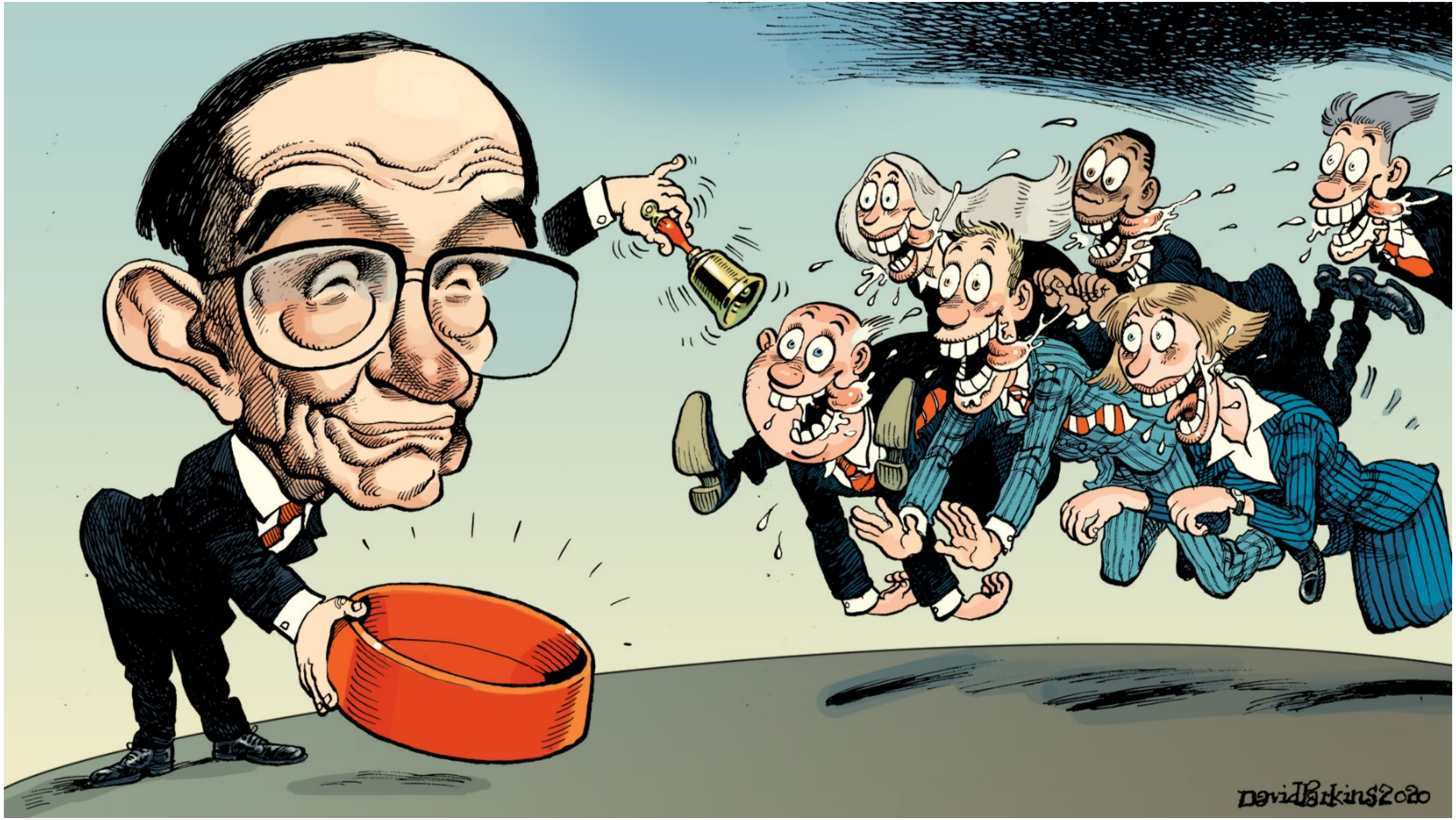


Image courtesy of DavidParkins.com

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GFC2: The Bowl's Empty

(Eurodollar University)