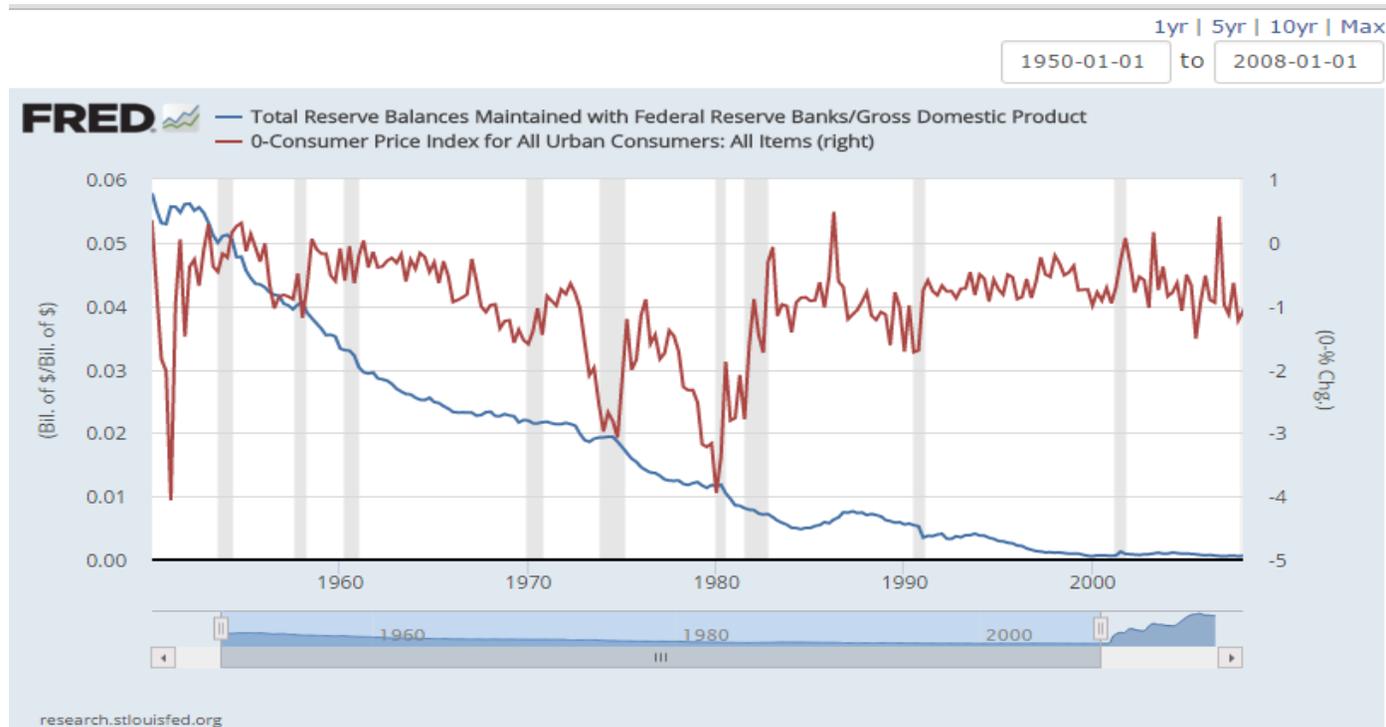


Fed has imposed a negative real deposit rate on bank reserves for 80 years

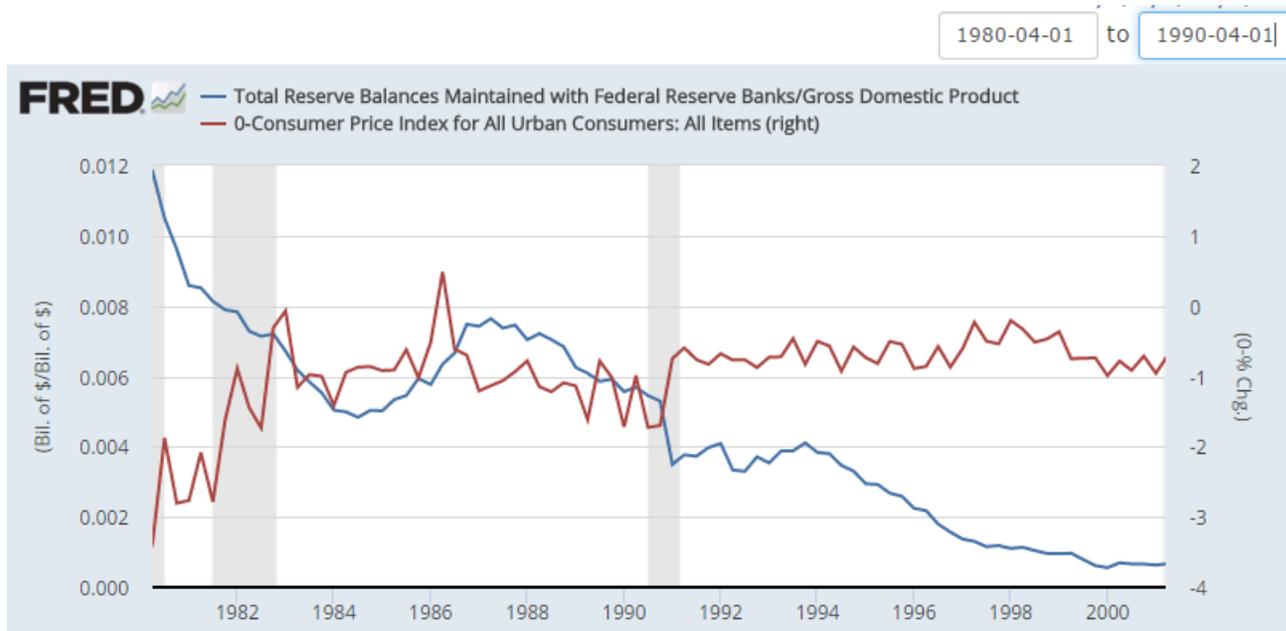
I seem to remember from those hazy crazy school days that only real interest rates matter.

So why is an ECB nominal deposit rate cut of 10 bps global news when the Fed has been paying a negative real rate on reserves at least since about 1936. Nominal zero, real equal to 0 minus the inflation rate. Here are a couple of snap shots. Best wishes ECB!



Note CPI is the quarterly change, not annualized. Reserve balances are scaled by GDP.

Seems like the exponential trend downward in demand for bank reserves was not impacted by changes in the real deposit rate.



As inflation fell post-Volker the real deposit rate increased. Does not seem to have impacted demand for reserves.

Bank reserves have been virtually flat in the US since 1950.

Reserves in the US have been unrelated to inflation, real gdp, loan growth, financial deepening, and just about any other important variable that can be imagined for the last 75 years.

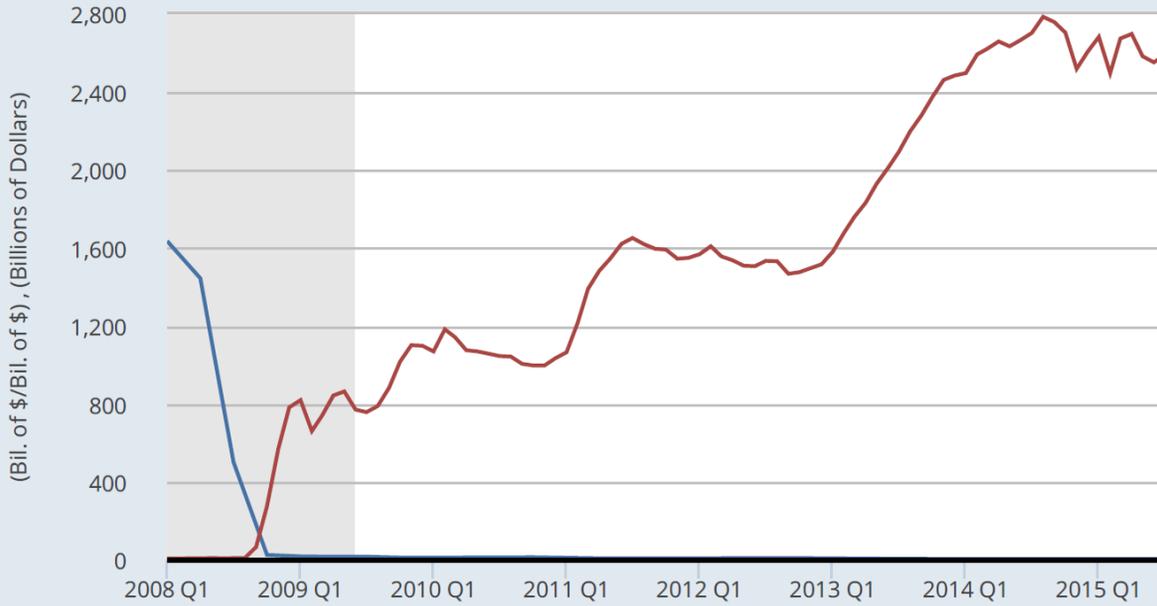
The last snapshot shows what has happened to the US income velocity of bank reserves post Lehman.

Velocity (GDP/B) is the inverse of the proportion of bank reserves held as a fraction of GDP (the blue line shown in the two charts above)

Did the US payments system suddenly become so inefficient that it now takes 90 units of reserves to clear and settle the same transactions that required only 1 unit of reserves pre crisis? Of course not. Banks are holding \$2.7 trillion in excess reserves. The bank reserves market is out of equilibrium. Lowering the deposit rate simply increases the size of the disequilibrium.



— Gross Domestic Product/Total Reserve Balances Maintained with Federal Reserve Banks
— Total Reserve Balances Maintained with Federal Reserve Banks



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Looks like velocity is “down for the count”. And this is where the Eurozone is headed.... Is a negative deposit rate the cure? Good luck!

Peter Stella

Stellar Consulting LLC

1 December 2015