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Why Aren’t Banks Loaning? An Analysis of Over $1 Trillion in Excess Reserves in the United States Banking System After the Financial Crisis of 2008-09

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Honors Capstone Project in Economics

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Abstract

This thesis examines the subject of the maintenance of historically unprecedented levels of excess reserves during the financial crisis of 2008-09 and beyond. The thesis first provides an overview of how the buildup of excess reserves happened within the context of the credit crunch. A review of United States' legislative intervention follows. Basic implications of the maintenance of very high excess reserve levels are then discussed, with an emphasis on how this condition has hindered economic recovery. The Federal Reserve Board's role is explored. This is followed by a comparison of the current financial crisis to a similar crisis that was experienced in the 1930's; similarities and differences are reviewed.

The thesis focuses on factors that may have influenced the problem with the excess reserve levels. It begins with a review of demand side influences followed by a review of supply side influences. Demand side influences include: fewer small businesses looking for credit, fewer firms purchasing capital equipment and expanding workforce, firms deleveraging balance sheets and lower sales presented businesses from growing. Supply side influences include: banks deleveraging their balancing sheets and attempting to restore crucial financial ratios, regulators tightening standards, banks fearing collapse, and banks experiencing difficulty accurately valuing their assets. The last section consists of a conclusion, based upon findings from this investigation. Implications for additional research follow.

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