Banks’ operating balances on deposit at Federal Reserve Banks have been declining over most of the past decade. Banks hold these balances for two reasons: as reserve balances that, along with vault cash, satisfy legal reserve requirements and as service-related balances that banks voluntarily contract to hold for handling interbank payments. (Balances other than these are relatively stable and low.) The decline in operating balances can be gauged roughly by the rapid increase in the ratio of nominal GDP to balances. In effect, more and more economic and financial interbank business is being transacted with a progressively smaller amount of central bank deposit money.

The decline in the actual volume of operating balances is masked by related, more familiar measures of base money. Operating balances are the quantity that the Federal Reserve controls in implementing monetary policy through open market operations to regulate the federal funds rate. Monitoring the supply of base money, however, requires careful attention to shifts in demand such as those instigated by changes in reserve requirements and by new banking technologies such as sweep accounts that economize on required reserves. Making those two adjustments turns the 1990s’ decline in actual bank reserves into an increase in the reserves component of the monetary base.

Policy analysts also have been concerned that volatility in the fed funds rate might increase as uncontrollable changes in the daily supply of central bank money loom larger in determining its quantity. This, however, does not seem to have been a problem.