Lagged Reserves

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DEFINITION of Lagged Reserves

Lagged Reserves is a method of bank reserve calculation whereby the financial institution is required to keep a certain level of reserves with a Federal Reserve bank. The amount of reserves required is based on the value of all outstanding deposits in the bank's demand deposit accounts from two weeks prior.

BREAKING DOWN Lagged Reserves

Lagged reserve calculation was used from the late 1960s until 1984, when contemporaneous calculations were implemented. But the Fed decided to revert back to the lagged calculation in 1998 in order to obtain more accurate data. This type of reserve calculation is still being used today.

How Lagged Reserves Work

Reserve requirements are the amount of cash that banks must have, in their vaults or at the closest Federal Reserve bank, in line with deposits made by their customers. Set by the Fed's board of governors, reserve requirements are one of the three main tools of monetary policy — the other two tools are open market operations and the discount rate.

The system of lagged reserves requires a bank's currency reserves held with the Federal Reserve to be tied to value of its demand deposit (checking) accounts 14 days earlier. If all of