Macro Roundup Article

Headline: Fed Balance Sheet Shrinkage May Be Smaller Than It Seems

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Tweet: .@Matt_Klein notes that recent Fed balance sheet shrinkage has apparently not cooled the economy because it has primarily been driven by sales of bonds of under 5 years duration, while the composition of the Fed’s liabilities has become more liquid.

Summary: The composition of the balance sheet matters at least as much [as its size]. Between mid-2014 and mid-2016, the Fed’s bondholdings shrank by 30% in duration-adjusted terms even as the face value of the portfolio was unchanged. More recently, the duration-adjusted decline has been barely visible despite substantial declines in the par value of the bond portfolio. Since October 2022, the average duration of the Fed’s Treasury portfolio has lengthened from 6 to 6.5 years. [Turning from the asset to the liability side], not all Fed liabilities are equally important. Reserves held by banks as deposits at the Fed play a different role in the financial system than the federal government’s deposits in the Treasury General Account. And both are different from the Fed’s reverse repo facility, which lets money market funds earn a competitive interest rate while lending to the Fed overnight. Changes in reserve balances seem to be more important than the others for risk-taking conditions.

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Primary Topic: Business Cycle

Topics: Business Cycle, GDP, Inflation, Monetary Policy, Op-Ed/Blog Post

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