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ECONOMY

# The Fed Is Buying Treasurys Again. Just Don't Call It Quantitative Easing.

Central bank is buying assets for sole purpose of fine-tuning liability side of its balance sheet

'This is not QE,' said Fed Chairman Jerome Powell. 'In no sense is this QE.' PHOTO: THOMAS PEIPERT/ASSOCIATED PRESS

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The Federal Reserve began buying short-term Treasury debt Tuesday at an initial pace of $60 billion a month, but officials say these purchases are nothing like the bond-buying stimulus campaigns unleashed by the central bank between 2008 and 2014 to support the economy.

Here are answers to six commonly asked questions about what is happening:

**Q: What is the Fed doing?**

The Fed began buying Treasury bills on Oct. 15 at an initial pace of $60 billion a month because officials concluded that last month's dysfunction in very-short-term lending markets may have resulted from allowing its $4 trillion portfolio to shrink too much.

**Q: What happened in money markets last month?**

Large payments of corporate taxes and Treasury auction settlements on Sept. 16 resulted in a large transfer of cash from banks to the government. A mismatch in the demand and supply for cash put pressure on a critical funding market in which banks lend to each other overnight through repurchase agreements, or "repo."

This year, repo rates usually have been no more than a 10th of a percentage point above the midpoint of the benchmark federal-funds rate, or around 2.2% in August and early September. Repo rates rose to 5% on Sept. 16.

Pressure intensified when Wall Street firms' repo desks began rolling over loans early Sept. 17, with the repo rate rising as high as 10%. Even then banks refused to lend, passing up big profits to hold on to their cash.

The dysfunction led the Fed's benchmark federal-funds rate to rise to 2.3%—above its then-target range of between 2% and 2.25%. This hadn't happened since the central bank began setting a range during the 2008 crisis.

The Fed began injecting cash into money markets on Sept. 17 to pull down interest rates, and it has conducted overnight lending operations every business day since then to keep markets functioning smoothly.

**Q: Even if the Fed restored order, did the central bank play any role in contributing to this volatility?**

Yes, according to some Fed officials and outside observers. To understand how, it helps to review changes in the central bank's asset portfolio, sometimes called a balance sheet, over the past two years.

Between 2008 and 2014, the Fed dramatically expanded its portfolio to stimulate the economy. In 2017, central bank officials began shrinking their holdings by allowing some Treasury and mortgage securities to mature without replacing them.

When private investors buy bonds, they use cash, borrow funds or sell assets to raise money to fund those purchases. The Fed is different. It doesn't have to do any of that because it can electronically credit money to the bank accounts of bond dealers that sell mortgage and Treasury securities. The Fed gets the bonds, and the sellers' bank account increases by the same amount as the bonds' value. Banks keep deposits at the Fed, known as reserves, and when the Fed buys bonds from banks, their reserves rise by an equal amount.

When the Fed started shrinking its balance sheet in 2017, it put the process in reverse. As the Fed's holdings of Treasury bonds matured, balances in the Treasury's general account at the Fed declined by the same amount; when the Treasury issued a new security to private investors to replace the maturing one, banks fund those purchases by reducing their reserves. Reserves peaked at $2.8 trillion in 2014 and had fallen to less than $1.4 trillion by mid-September.

Everyone knew there would come a time when reserves would grow scarce enough that banks might charge more to lend in overnight money markets, but experts inside and outside the Fed weren't quite sure where that level was. Since the 2008 financial crisis, banks' demand for reserves is much higher than it used to be because of changes in financial regulation and market structure.

Some Fed officials thought reserves wouldn't grow scarce until they fell to less than $1.2 trillion based on surveys they had been conducting over the past year. But the repo market volatility from Sept. 16 to 17 suggested the Fed may have misjudged demand for reserves and allowed them to fall too low.

**Q: How does the Fed's purchases of Treasury securities help fix the problem?**

If Fed officials concluded that they drained too many reserves from the system, a permanent fix would be to add reserves to the system. Buying Treasury bonds will create the reserves the Fed now thinks are needed to implement its policy decisions.

**Q: How many securities will the Fed need to buy?**

It depends on how big a "buffer" of extra reserves the Fed wants to maintain. The Fed has said its purchases of short-term Treasury bills will continue into the second quarter of next year, though it hasn't committed to buying at a $60-billion-a-month pace beyond the first month of purchases.

Fed officials have said they want to return reserves to at least a level that prevailed in early September, when they were at nearly $1.5 trillion. If not for the Fed's current repo market intervention, reserves would be at around $1.35 trillion.

Without the new purchases, reserves would decline even lower because other liabilities on the Fed's balance sheet are growing. These liabilities include currency in circulation, the Treasury's general account and certain services the Fed offers to foreign central banks.

For example, the Treasury is replenishing its general account after drawing it down this summer when it was using emergency measures to remain below the debt limit. Growth in currency and the Treasury's general account could reduce reserves by another $150 billion this year.

Even though the Fed is likely to taper its purchases of Treasury bills in 2020, it will need to continue buying smaller amounts of Treasurys—likely no more than $15 billion a month—simply to keep up with currency growth.

**Q: The Fed bought bonds to stimulate the economy between 2008 and 2014. Isn't this the same thing?**

Not according to the Fed. The central bank has taken pains to emphasize that these purchases don't represent a return to what is known as quantitative easing, or QE.

Make no mistake: the Fed is buying a lot of securities—more than most analysts who closely monitor bond markets anticipated. In addition to $60 billion in Treasury bills, the Fed is buying up to $20 billion every month in a wider range of Treasury securities to replace maturing mortgage securities. By way of comparison, the Fed bought $85 billion a month in Treasury and mortgage securities between December 2012 and October 2014 in its largest and final round of quantitative easing.

There are three ways in which these purchases are different from QE.

First, QE was designed to inject more liquidity into the banking system than was needed to spur more risk-taking and boost growth. The Fed isn't doing that this time. Instead, it is buying assets for the sole purpose of fine-tuning the liability side of its balance sheet.

Second, Fed officials believed QE was effective because the central bank bought long-term securities, lowering long-term rates and driving investors into stocks and bonds. The Fed's latest purchases are concentrated in short-term bills that officials believe provide much less stimulus.

Third, QE had potentially powerful effects by telling investors about the Fed's broader intentions to stimulate the economy, including by keeping rates lower for longer than might otherwise have been the case. The Fed isn't doing that this time and instead has gone out of its way to say the opposite—that its latest purchases are technical measures designed to have "no material implications for the stance of monetary policy," according to a primer the Fed published on Friday.

"This is not QE," said Fed Chairman Jerome Powell last week. "In no sense is this QE."

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