The Balance Sheet: During and After Normalization

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Fed's Balance Sheet (Billions of dollars)

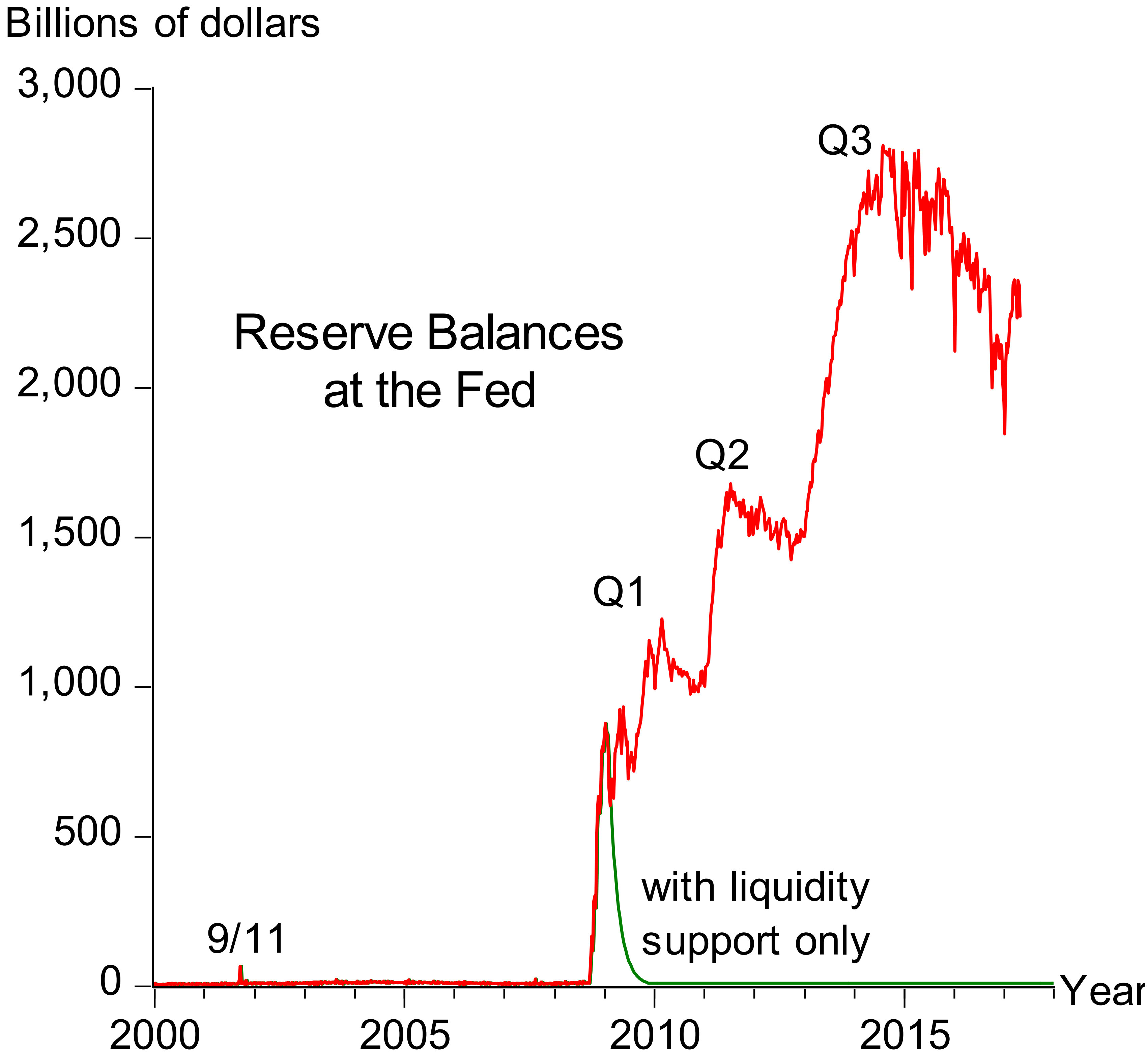
April 26, 2017

Assets		Liabilities	
Securities Held Outright	4,246	Federal Reserve Notes	1,496
Other	224	Reserve Balances	2,201
		Other	733
Total Assets	4,470	Total Liabilities	4,430

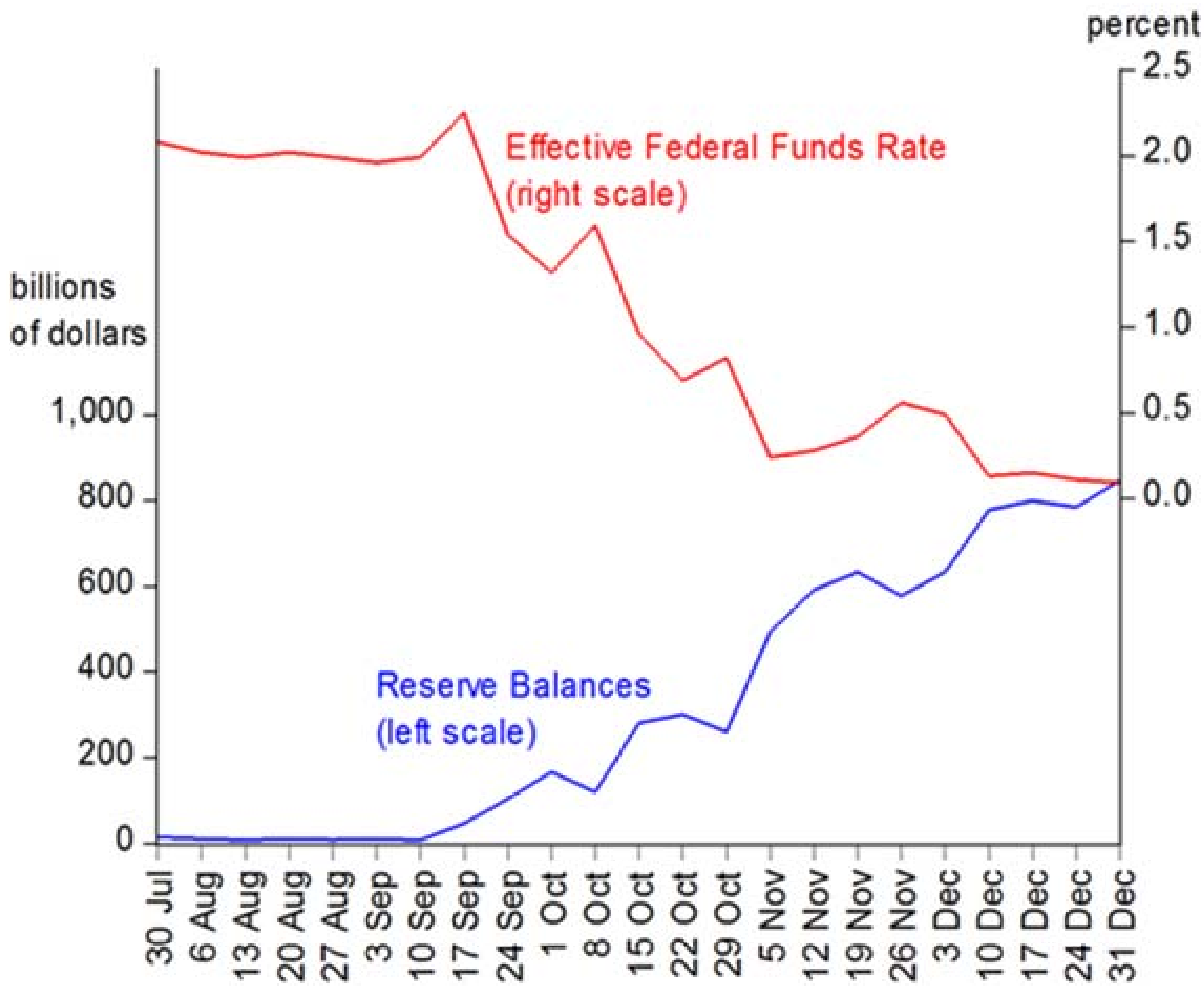
May 10, 2006

Assets		Liabilities	
Securities Held Outright	760	Federal Reserve Notes	758
Other	82	Reserve Balances	14
		Other	41
Total Assets	842	Total Liabilities	813

Source: Consolidated Statement of All Federal Reserve Banks, Federal Reserve Statistical Release H.4.1, Table 5, April 26, 2017; Table 2, May 11, 2006, Selected Items



Billions of dollars
3,000
2,500
2,000
1,500
1,000
500
0
Reserve Balances
at the Fed
Q3
Q2
Q1
9/11
with liquidity
support only
2000
2005
2010
2015
Year


percent
billions
of dollars
Effective Federal Funds Rate
(right scale)
Reserve Balances
(left scale)
2.5
2.0
1.5
1.0
0.5
0.0
1,000
800
600
400
200
0
30 Jul
6 Aug
13 Aug
20 Aug
27 Aug
3 Sep
10 Sep
17 Sep
24 Sep
1 Oct
8 Oct
15 Oct
22 Oct
29 Oct
5 Nov
12 Nov
19 Nov
26 Nov
3 Dec
10 Dec
17 Dec
24 Dec
31 Dec

Normalization and Afterword

- Normalization should be predictable and strategic
  - Lessons learned from taper tantrum and follow up
- Recall that interest rate used to be determined by S&D for reserves.
  - It was “market determined.”
- Now short-term interest rate is “administered” through IOER.
- After normalization the interest rate should again be determined by D&S--by market forces.
- As a long-term policy, a disconnect between the short-term interest rate and the supply of reserves creates problems.
  - Enables the Fed to be a multipurpose institution—helping one sector or another, taking on credit allocation,…
  - Questions will be raised about its independence.
  - More appropriate for Treasury or other agency with approval of Congress.

Different Views about Eventual Size

- More reserves are needed for liquidity:
  - The payments system would not adequately function without large intraday credit to banks (daylight overdrafts).
  - But with some reforms, such as giving a specific limit on the amount of overdrafts as a percentage of collateral, the system could run smoothly with a smaller amount of reserves.
- Fed could provide deposits for anyone—not just banks
  - But that service could be provided by Treasury debt management.
- A permanently large balance sheet would allow quantitative easing to be an easy to use tool of policy
  - Maybe not such a good idea!