



Why Is the Fed's Balance Sheet Still So Big?

Council on Economic Education

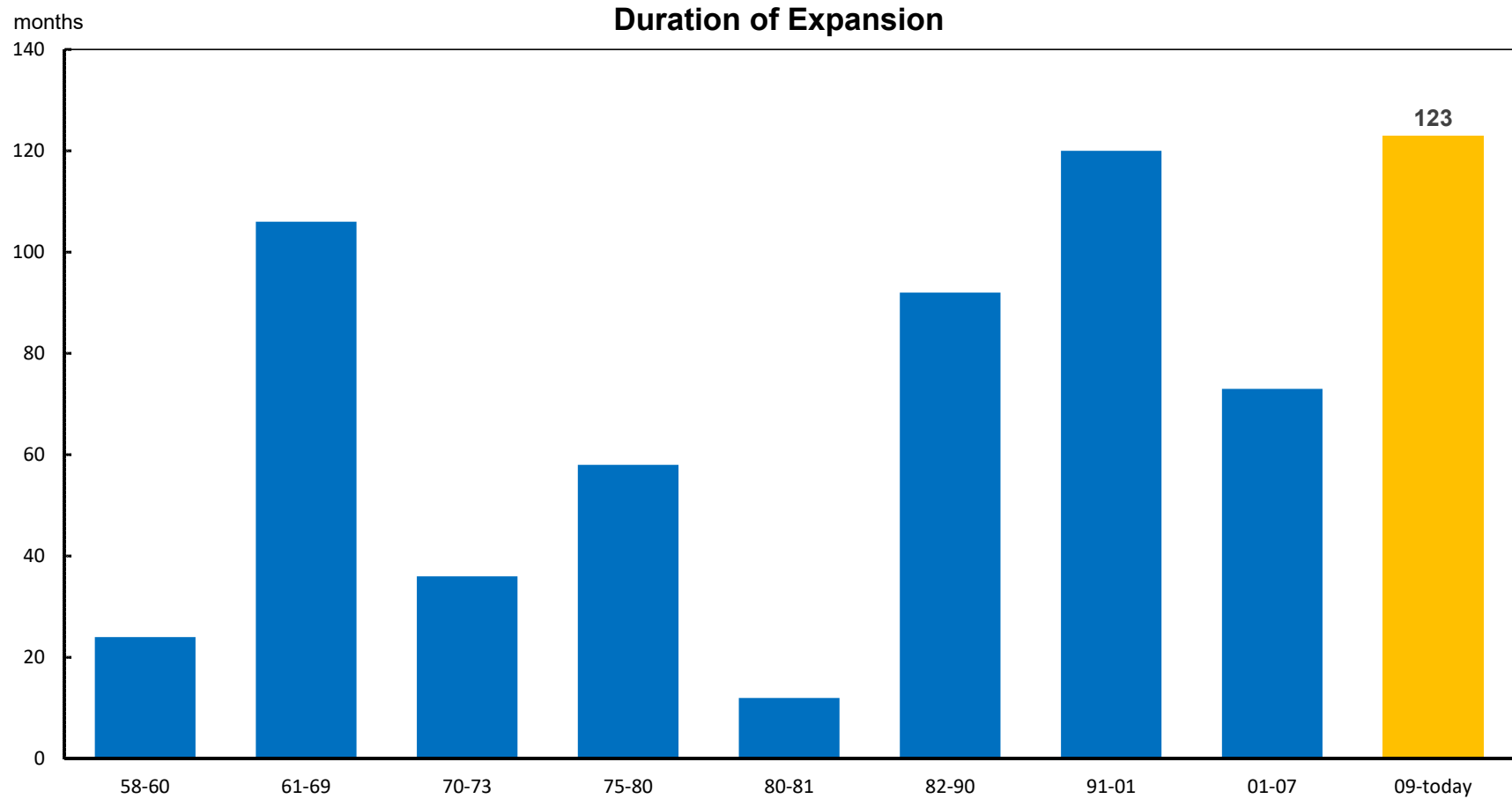
October 4, 2019

Sylvain Leduc

Executive Vice President & Research Director



We are now in the longest expansion on record



Source: NBER

But back in 2009, the picture was not so rosy

Unemployment Rate

10%

Fed Funds Rate Target

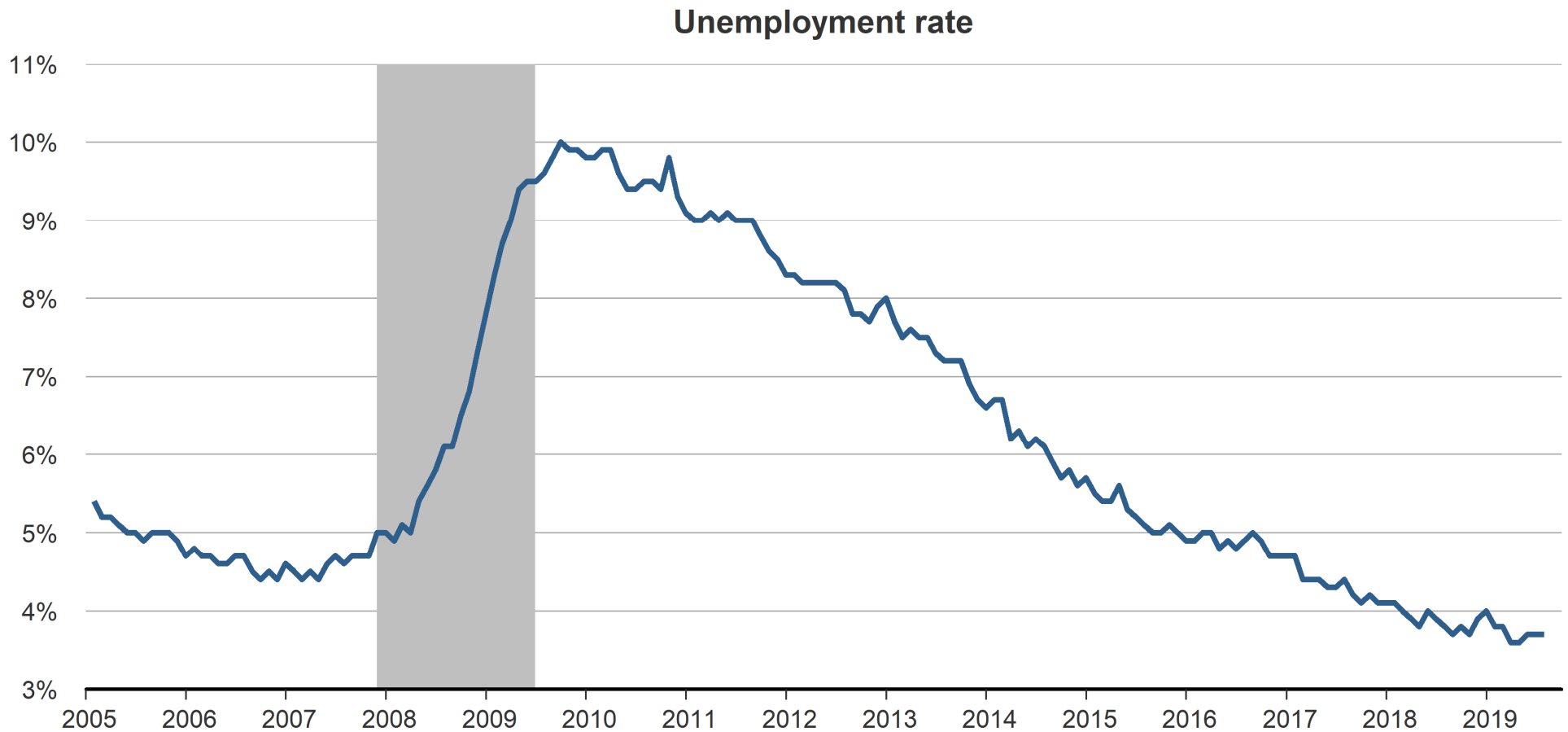
0.125%

Unconventional Monetary Policies

Forward guidance

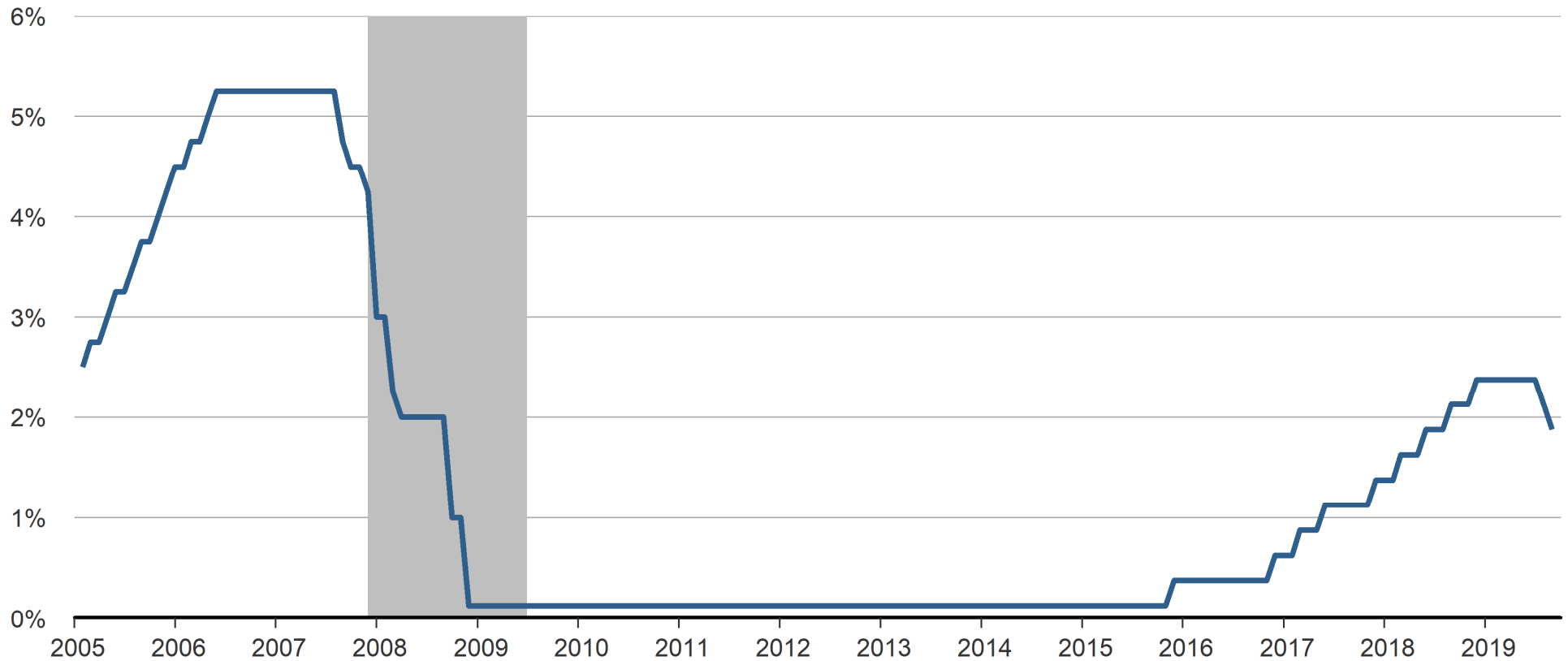
Quantitative easing

Since then, unemployment has steadily declined...



....and the fed funds rate lifted off in 2015

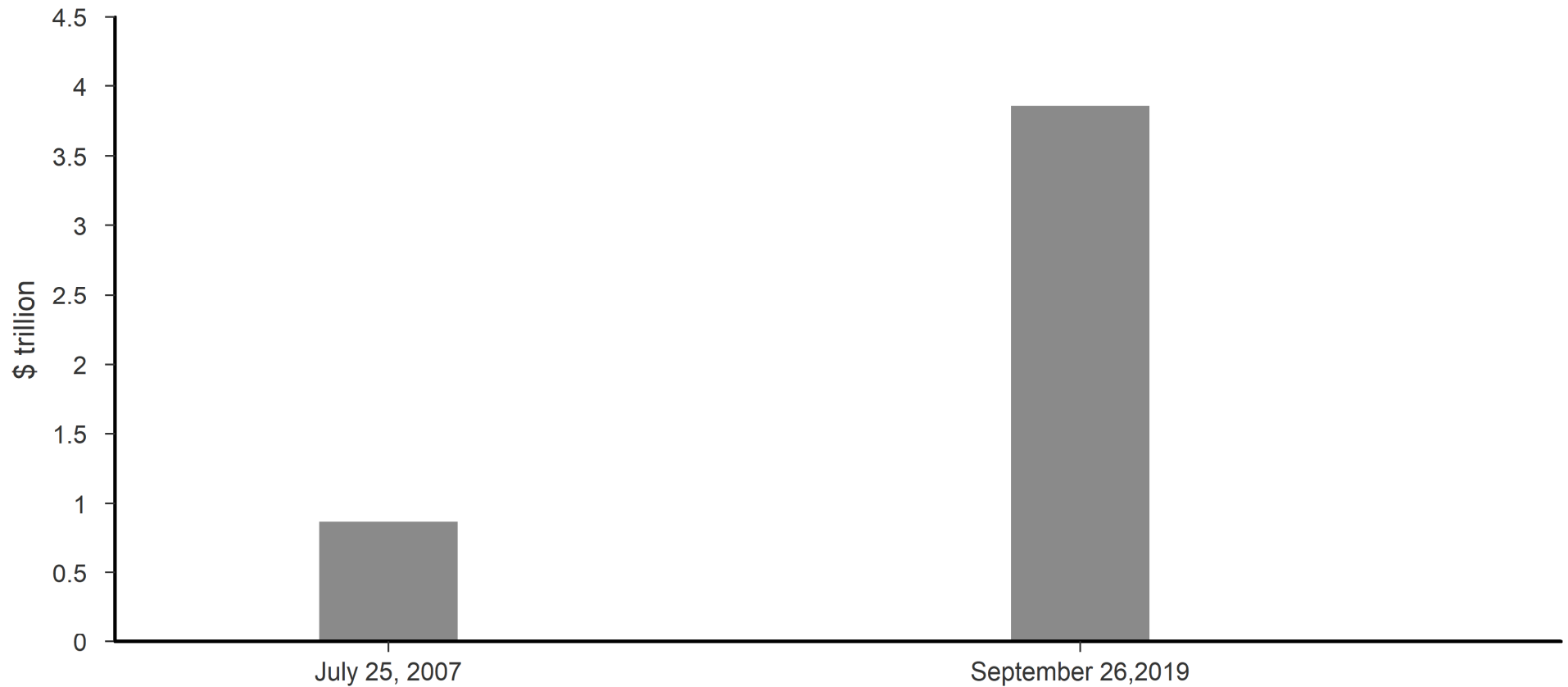
Federal Funds Target Rate



As of 12/16/08, the target measured as the average of the upper and lower limits of the target range of the federal funds rate.

Source: Federal Reserve Board/Haver Analytics.

So why is the Fed's balance sheet still so big?



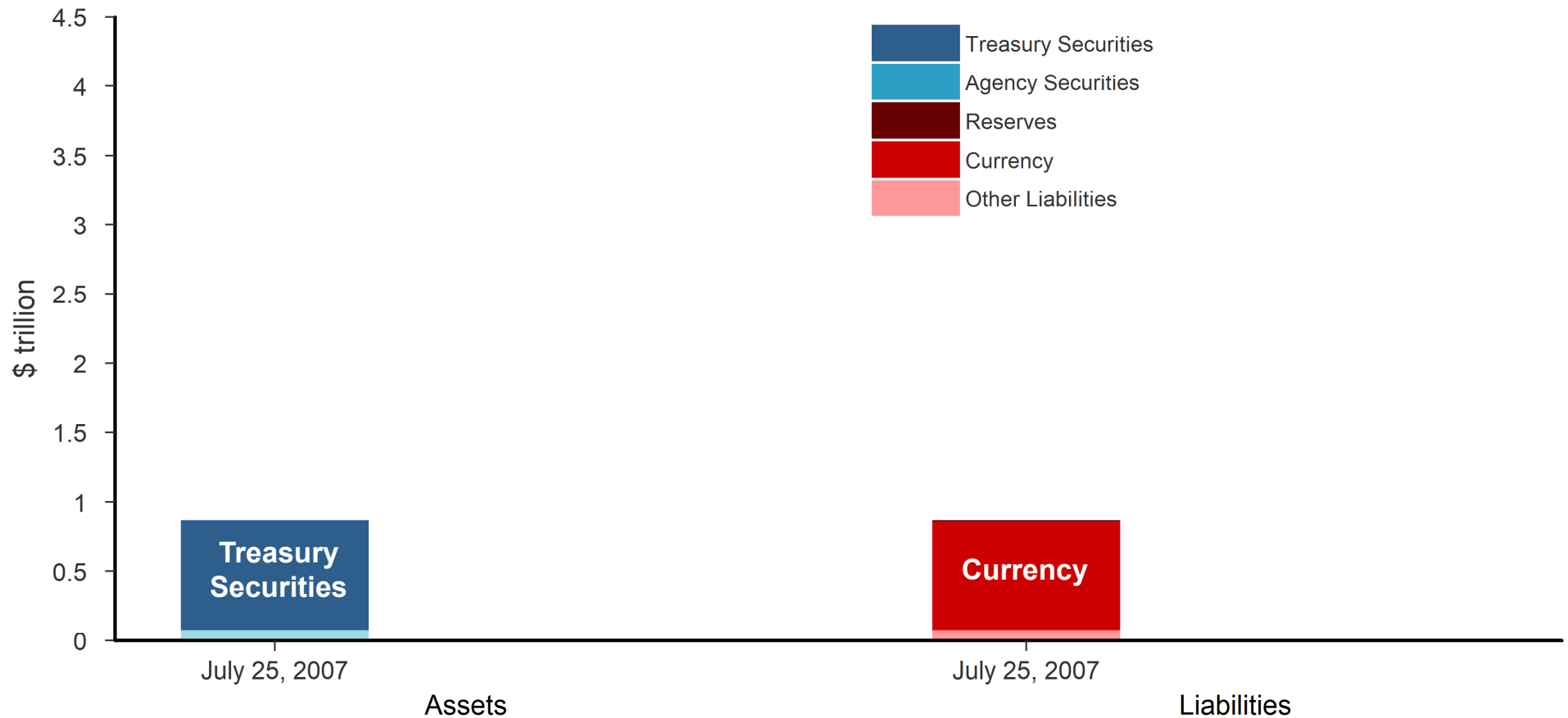
Source: Board of Governors

The Fed's balance sheet: A look under the hood

Key elements of the balance sheet

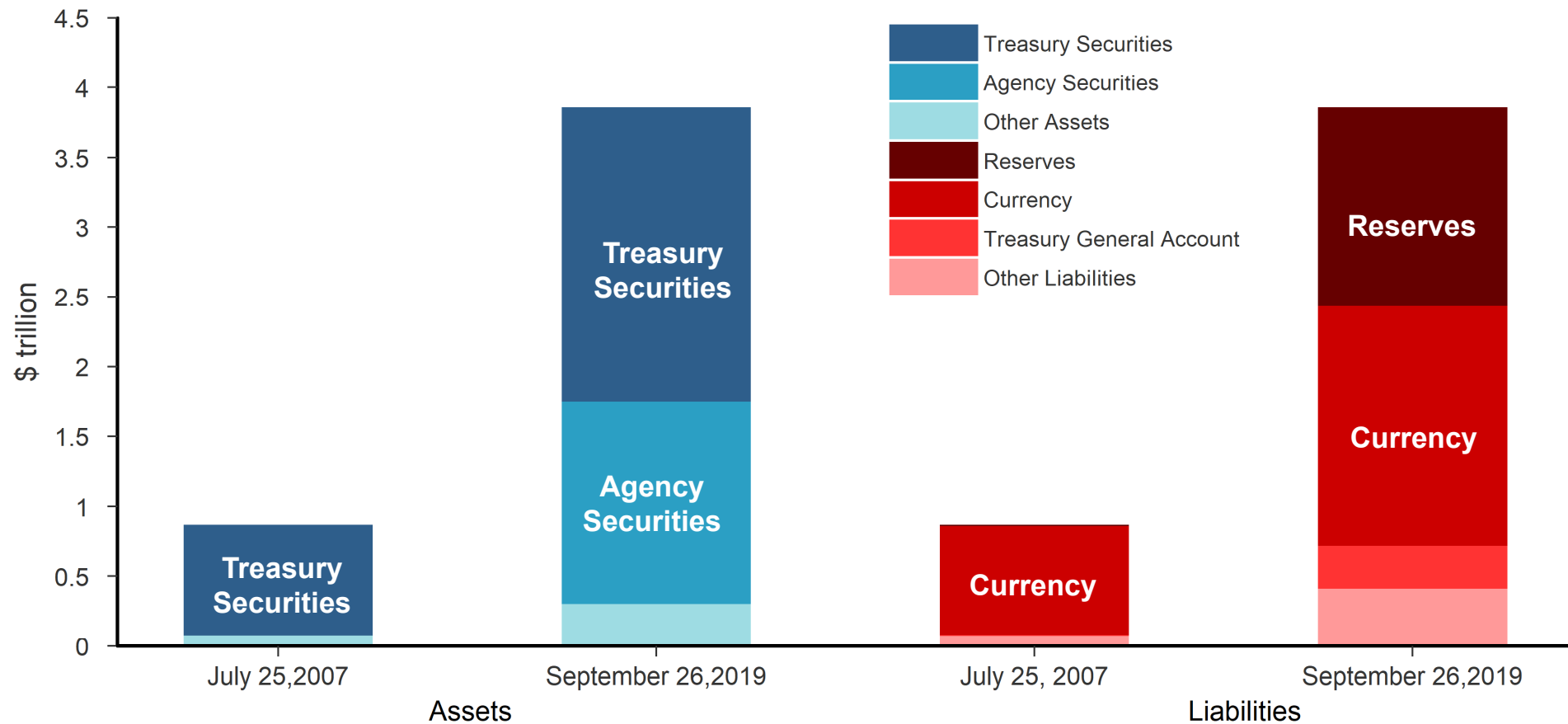
- **Assets**
 - **Treasury Securities**
 - **Agency Securities**
- **Liabilities**
 - **Currency**
 - **Treasury General Account**
 - **Reserves**

The balance sheet is larger than before the crisis



Source: Board of Governors

The balance sheet is larger than before the crisis



Source: Board of Governors

Communicating with the broad public

A Topic a Minute

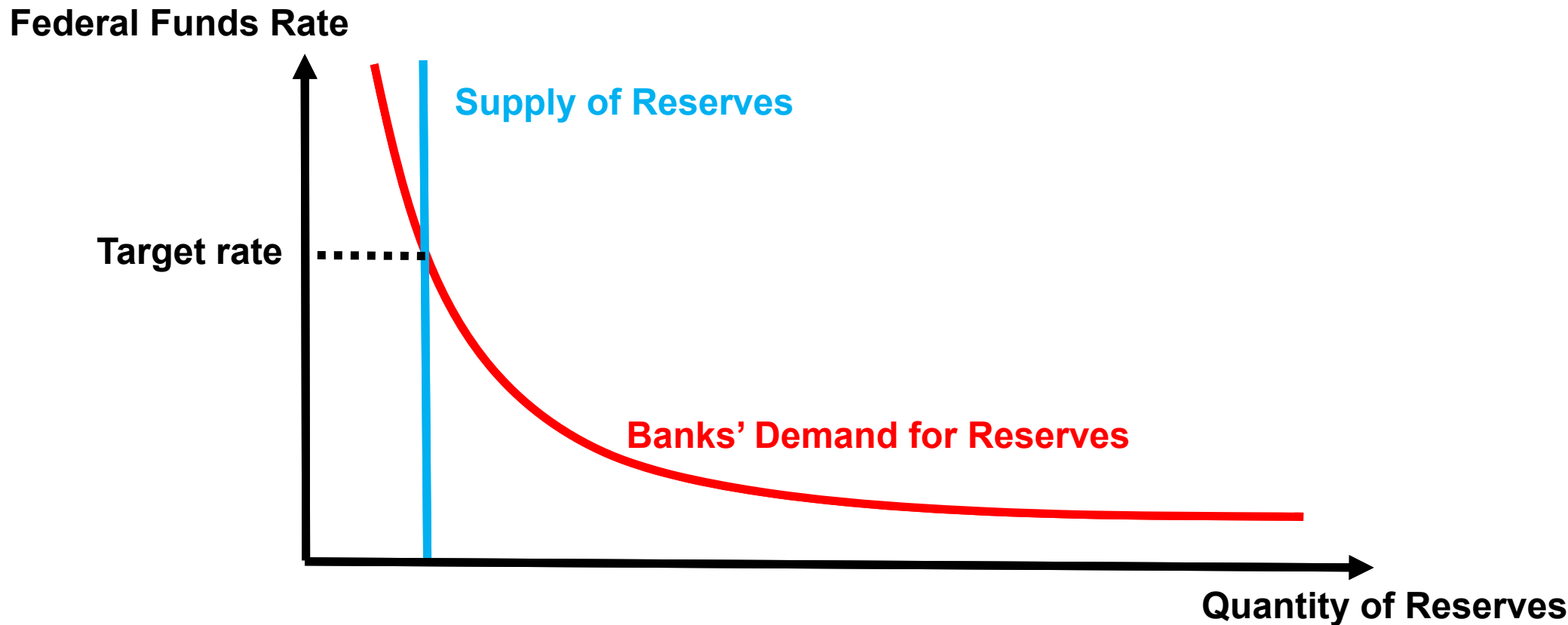
FEDERAL RESERVE



The Fed's larger balance sheet is here to stay

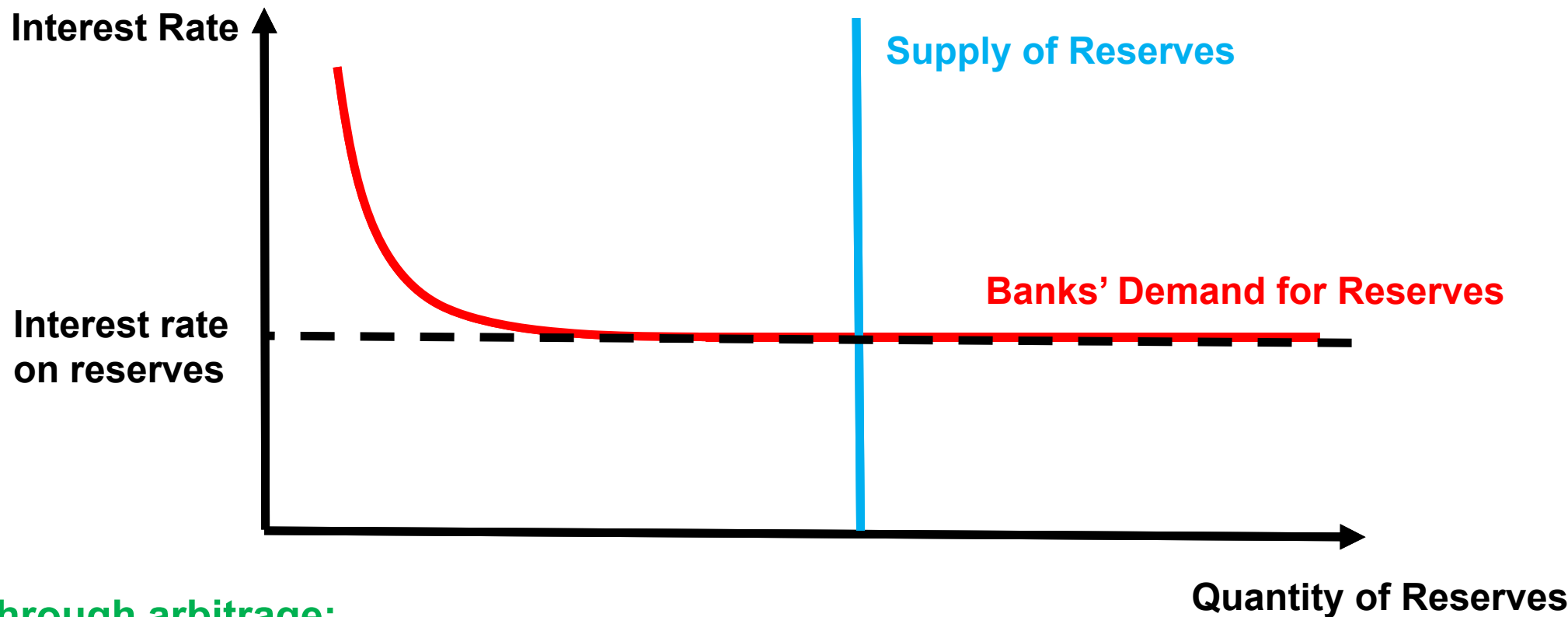
- **Currency in circulation has increased**
- **Fed decided to conduct policy with “ample” reserves using interest on reserves to affect the fed funds rate**
 - **Provides advantages for monetary policy and financial stability**
 - **Differs from the pre-crisis system of “scarce” reserves**

Pre-2008 policy was conducted with “scarce” reserves



Increases in the supply of reserves lower the federal funds rate

Policy is now conducted with “ample” reserves



Through arbitrage:
Increases in interest on reserves raises the federal funds rate

Monetary policy
in a low growth, low interest rate world

Slow growth is the problem of our time



What determines trend GDP growth?

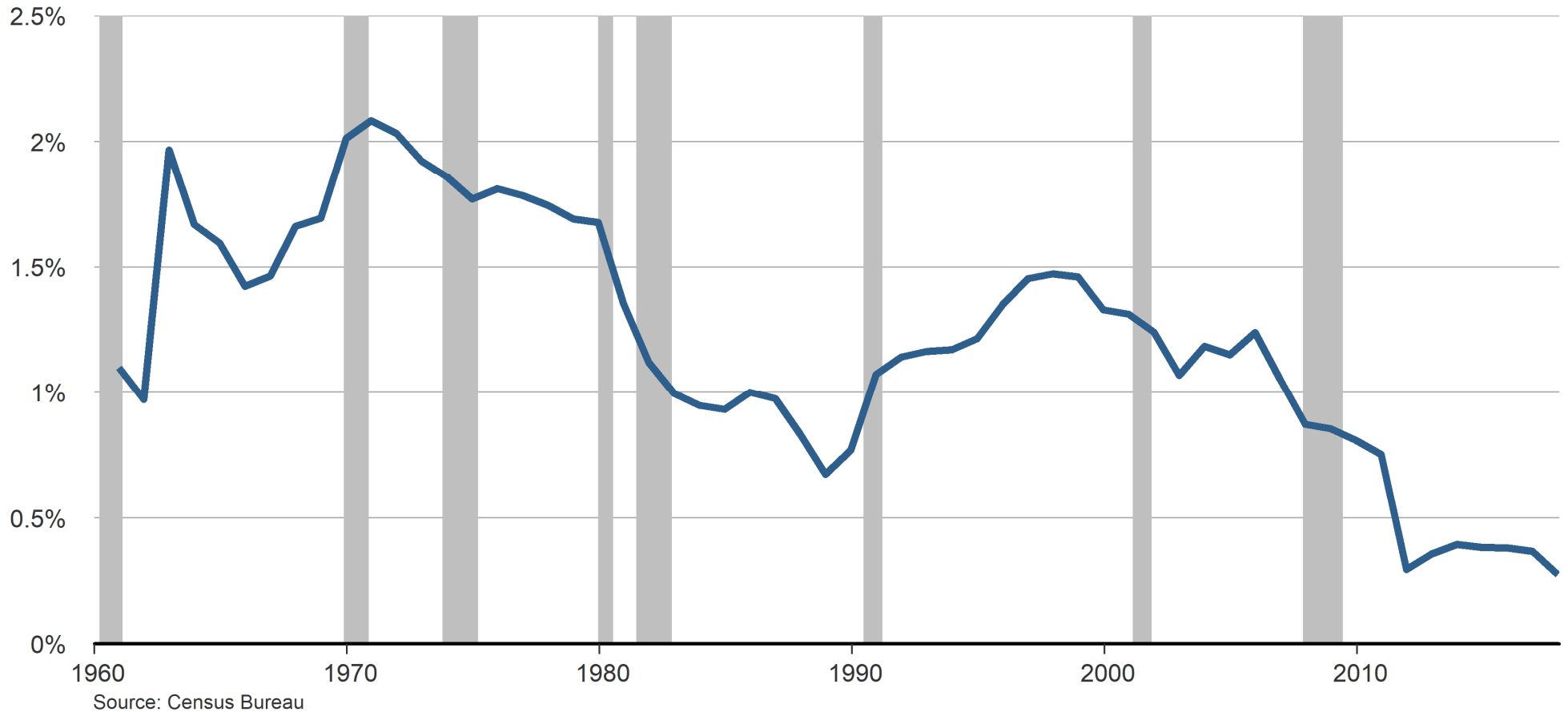
Output depends on

(i) Labor force (worker hours)

(ii) Productivity (output per hour)

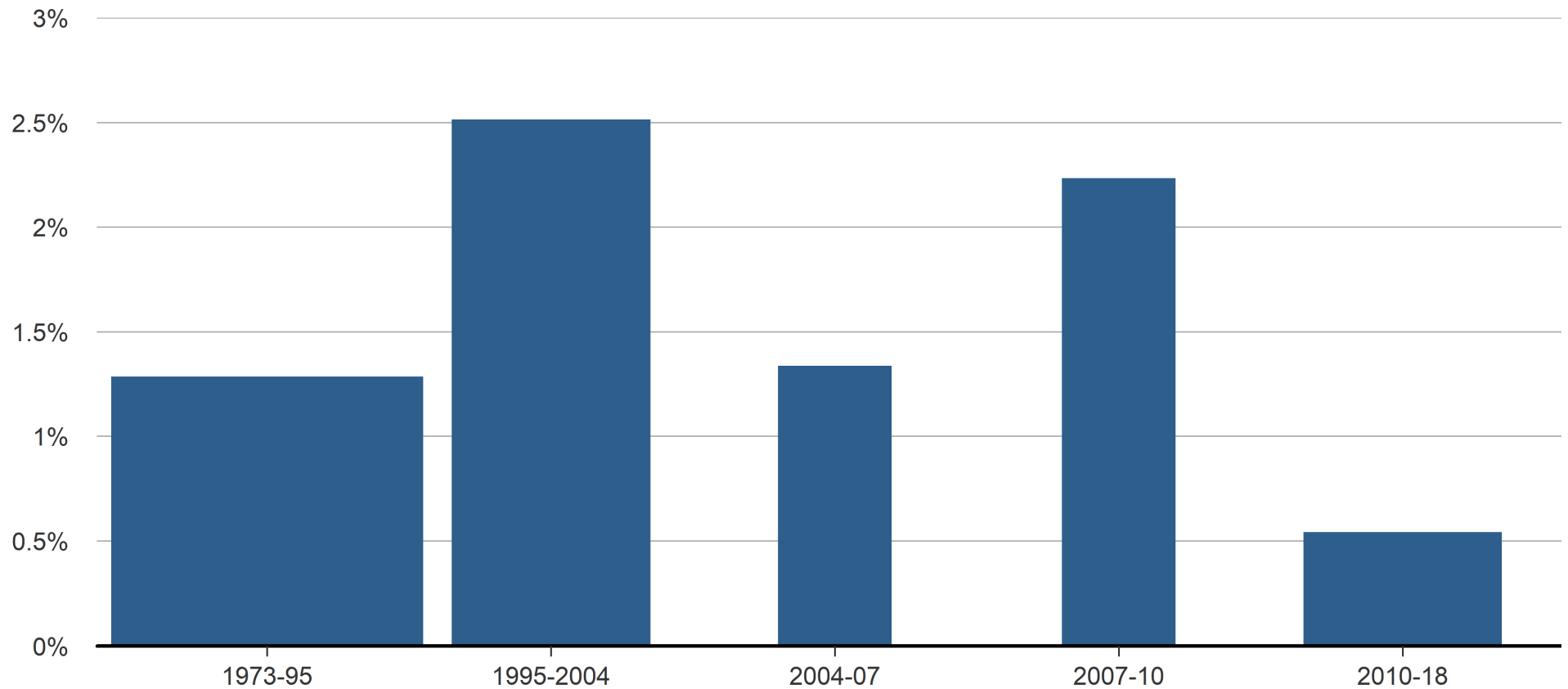
Demographics imply slow labor force growth

Actual growth in the working-age population: 16-64



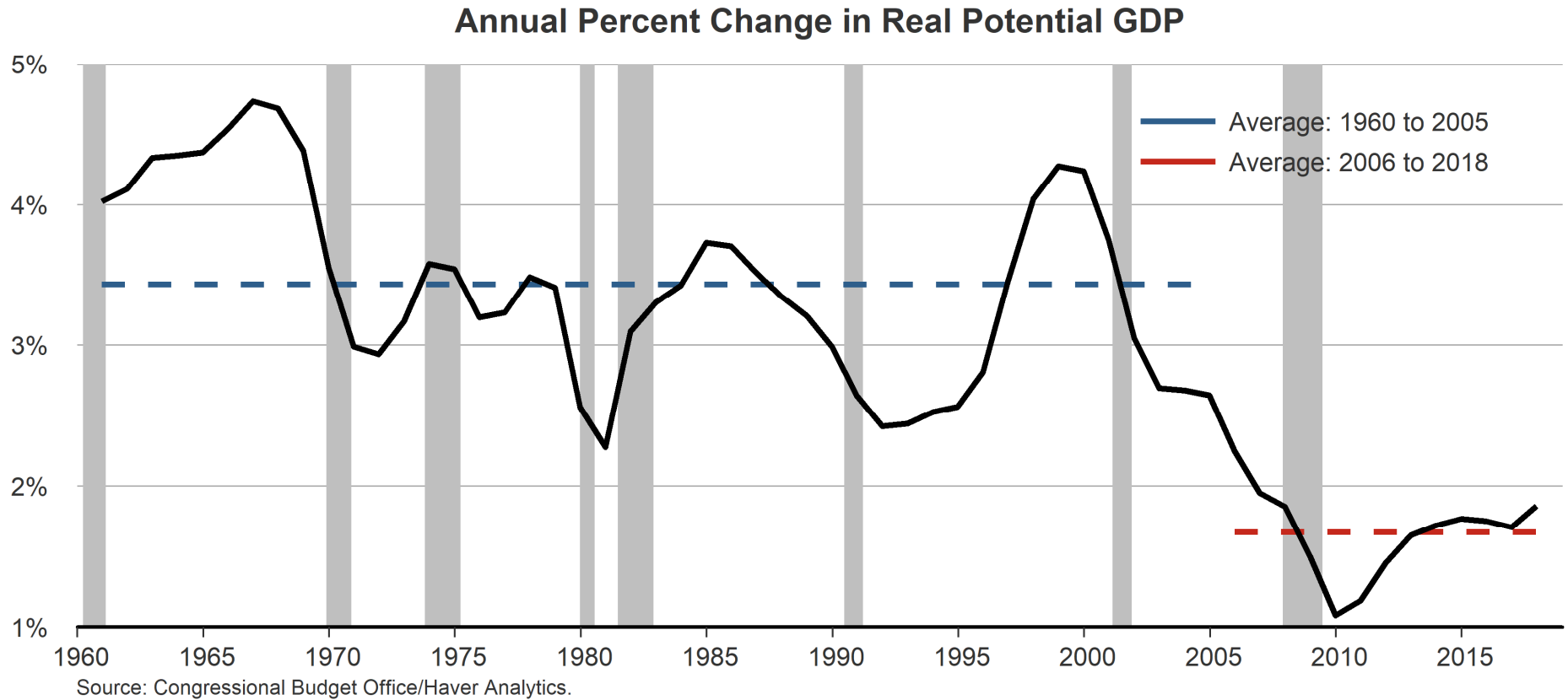
Productivity growth has been modest

Average annual growth in GDP per hour

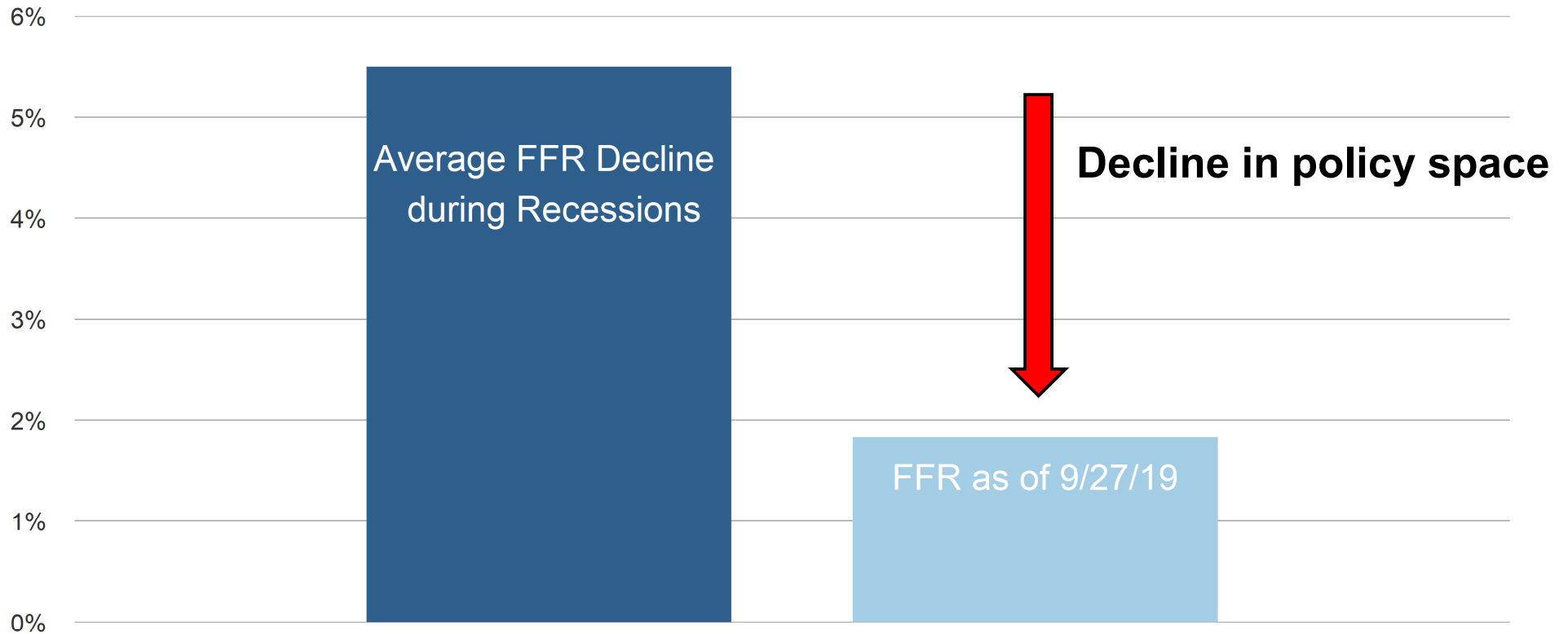


Source: John Fernald and Huiyu Li's 6/24/2019 FRBSF Economic Letter "Is Slow Still the New Normal for GDP Growth?"

Annual trend growth likely around 1.8%



Low growth is partly keeping interest rates low

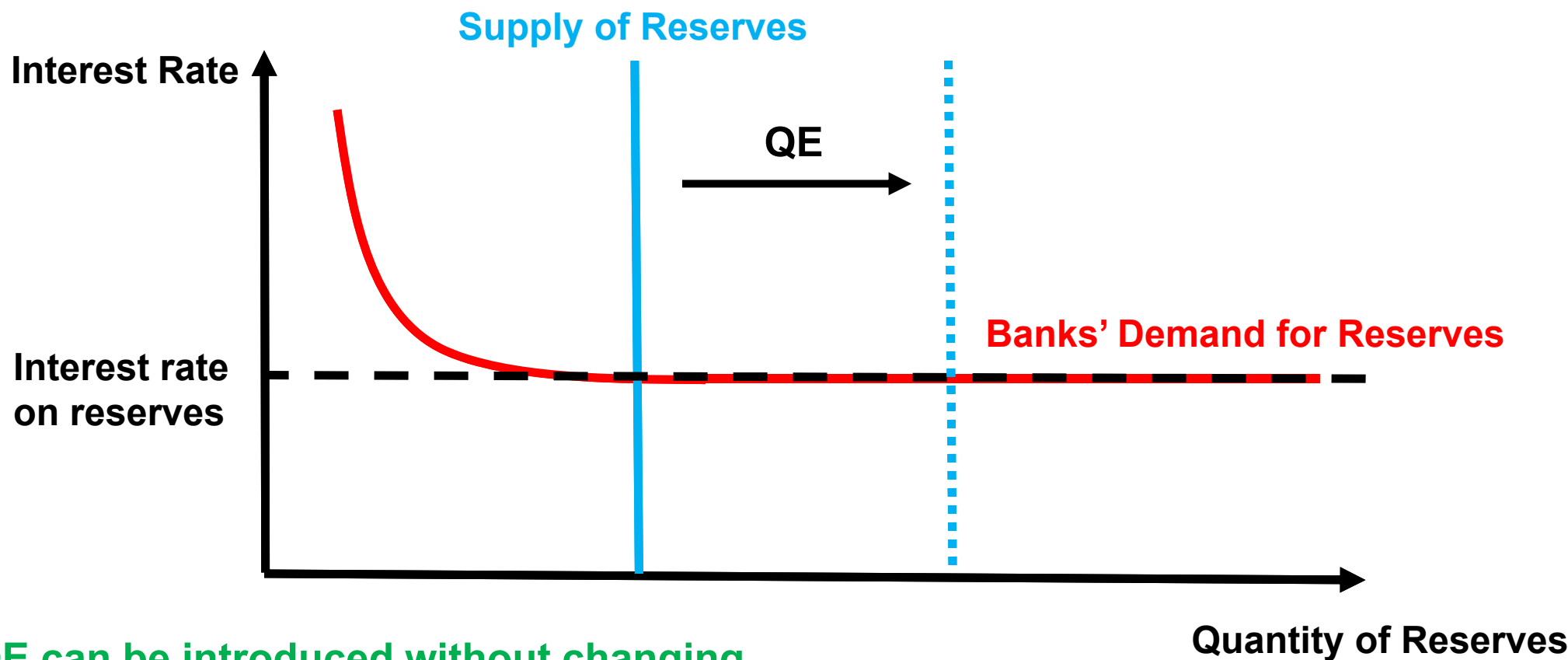


Source: The average is as reported in Janet Yellen's 8/26/2016 speech "The Federal Reserve's Monetary Policy Toolkit: Past, Present, and Future." The daily rate is as reported by the Board of Governors.

Low growth is partly keeping interest rates low

- **Lack of conventional policy “space”**
- **Thus, unconventional policies are likely to be used during future downturns**
- **QE can be seamlessly implemented in a regime of “ample” reserves**

QE seamlessly implemented with “ample” reserves



QE can be introduced without changing the implementation of monetary policy and the policy rate

A few takeaways

- **The Fed's larger balance sheet is here to stay**
- **Policy will be conducted with “ample” reserves using interest on reserves to affect the federal funds rate**
- **Seamlessly accommodates QE when needed**

More on the topic at frbsf.org

FRBSF Economic Letter

2019-16 | June 3, 2019 | Research from the Federal Reserve Bank of San Francisco

Why Is the Fed's Balance Sheet Still So Big?

Andrew Foerster and Sylvain Leduc

The Federal Reserve's balance sheet is significantly larger today than it was before the financial crisis of 2008–2009. Rising demand for currency due to greater economic activity is partly responsible for this increase. The balance sheet will also need to remain large because the Federal Reserve now implements monetary policy in a regime of ample reserves, using a different set of tools than in the past to achieve its interest rate target.