Press Releases

Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity Subcommittee Evaluates the Federal Reserve's Balance Sheet

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Yesterday, Committee Members reviewed the role of the Federal Reserve's balance sheet and explored how it has expanded and shifted in purpose over time. In addition, they covered how mismanagement may create economic and financial risks, including inflation and strains in Treasury market operations.

On the Growth and Evolutions of the Federal Reserve's Balance Sheet:

Task Force on Monetary Policy, Treasury Market Resilience, and Economic Prosperity Chairman Frank Lucas (OK-03) said, "Our focus today is on the Fed's balance sheet – a record of its assets and liabilities that demonstrate its operations. The Fed's balance sheet has undergone dramatic changes in the past 15 years – growing from less than $1 trillion in 2008, or 6% of GDP, to almost $9 trillion in 2022, or 35% of GDP."

Chairman French Hill (AR-02) said, "The Federal Reserve's balance sheet is a monetary policy tool that was once deemed unconventional some 15 years ago. Now, it's regularly used as a tool intended to keep our economy steady and secure. Since 2008, the Fed's balance sheet has grown significantly. In what began as a modest tool used to support traditional monetary policy during times of stress, appears to be the central way the Fed operates today."

Rep. Scott Fitzgerald (WI-05) said, "Since the 2008 financial crisis, the Federal Reserve's balance sheet has expanded dramatically and remains historically large, even after a period of quantitative tightening."

On Sustainability of the Federal Reserve's Balance Sheet:

Subcommittee on Housing and Insurance Chairman Mike Flood (NE-01) said, "Back before the financial crisis in 2008, the Federal Reserve's balance sheet was only around $900 billion. However, before the Federal Reserve began purchasing assets in 2020 to combat economic instability from the COVID-19 shutdowns, the balance sheet was already around $4 trillion. Today, the Federal Reserve's balance sheet is at $6.5 trillion, which is still higher than where the balance sheet was prior to 2020. If the Federal Reserve already has a $6 trillion balance sheet when the next recession hits, the Federal Reserve will be buying more assets on top of its already elevated holdings. My concern is whether this is sustainable long term."

Rep. Troy Downing (MO-02) questions the witness on what it would look like if the Fed shrank its balance sheet to pre-2008 levels, to which Dr. Clouse answered, "No, I don't believe it would be a wise decision. … we don't really know what reserve demand looks like. Also, I think the world is quite different now than it was in 2007. Notably, the federal debt outstanding is much, much larger than it was then. And there are linkages now between repo markets and overnight funding markets and money markets now that are just much larger than they were in the past. And we don't really understand those as well as we would need to in order to be able to make that that sort of move."

On How Regulations Affect the Fed's Balance Sheet:

Chairman Frank Lucas questions witness on whether regulators should contemplate the impacts liquidity requirements have on the size of the Fed's balance sheet, "Banking regulations like liquidity coverage ratio, resolution requirements, and liquidity stress test incentivize financial institutions to hold reserves, growing the fed's balance sheet." **To which Dr. Nelson replied,** "Yes, they should. Last week we conducted a survey of our member banks and published the results of that survey this morning on what leads to banks to demand reserve balances and what policies could change them. The things that the banks listed was, first and foremost, their own risk management, but then also, needing to pass liquidity requirements as well as discount window stigma. And, they indicated that the things that would most effectively allow them to reduce their demand for reserve balances was to recognize discount window capacity in the liquidity requirements to which they're subject."

Rep. Huizenga asks witnesses, "Why does the Fed still use quantitative easing to stimulate an economy when the economic community is not agreed whether the QE is actually even effective in the first place?" **To which Dr. Schrager responded,** " Well, certainly when, you know, we started with QE, interest rates were at a, you know, very near zero, and we were in the midst of a very deep recession. And, I think, the Fed was under a lot of pressure to feel like it was doing something. And it was something. It was supposed to just be an extraordinary situation because this was, you know, an extreme financial crisis, a very deep recession. But I think the concern is it went on for a really long time because it's very hard to get out of QE."

Witnesses Echoes the Work of the Committee:

Dr. Jim Clouse, Senior Fellow, Anderson Institute for Finance & Economics said, "A challenge in implementing the ample reserves regime is that while "ample" is reasonably clear conceptually it is not easy to quantify in practice. In the fall of 2019, with reserves [s]till [sic] very elevated by historical standards, a confluence of factors including large settlements of Treasury auctions and sizable taxrelated flows and corresponding reductions in reserves led to a brief period of severe stress in the repo market that spilled over to the federal funds rate."

Dr. Bill Nelson, Executive Vice President, Chief Economist, and Head of Research, Bank Policy Institute said, "Like any financial institution, the Federal Reserve has a balance sheet, and its assets and liabilities must match. Understanding the composition of that balance sheet is critical for understanding how the Fed conducts monetary policy, the relationship between the Fed and the financial system and the risks to taxpayers of the Fed's actions. The assets of the Fed are almost entirely Treasury securities and agency MBS. Other assets include discount window loans to insured depository institutions and, in some cases during crises, emergency loans to non-depository institutions."

Dr. Allison Schrager, Senior Fellow, Manhattan Institute said, "Some increase in the Fed's balance sheet is not necessarily a concern; it is part of a healthy and growing economy. But the reasons why the balance sheet has grown as much as it has, and the changing composition of its assets, should be a matter of grave concern for policymakers. There may be some justification for buying assets other than short-term Treasuries in extreme instances of illiquidity, but any such program should last only a short time—perhaps six months—after the liquidity event has passed, and should not be used as a way to manage economic demand or directly influence asset price."