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The Federal Reserve's balance sheet and earnings: a primer and projections

by Seth Carpenter, Jane Ihrig, Elizabeth Klee, Daniel Quinn and Alexander Boote[a]

Abstract

Over the past few years, the Federal Reserve's use of unconventional monetary policy tools has received a vast amount of public attention, from discussing how these asset purchases have put downward pressure on longer-term interest rates and thus supported economic activity to evaluating the implications for Federal Reserve remittances to the Treasury and the effect on monetary and fiscal policy. As the economic recovery has gained some momentum of late, the focus has turned to issues associated with the normalization of monetary policy. In this paper, we begin by providing a primer for the Federal Reserve's balance sheet and income statement. With that foundation in place, we then consider a variety of scenarios consistent with statements by Federal Reserve officials about how the FOMC will normalize policy, including whether to sell mortgage-backed securities, whether to change the composition of Federal Reserve liabilities, and the timing of lifting the federal funds rate off from the zero lower bound. In each of these scenarios, we discuss the implications of these normalization policies on the size and composition of Federal Reserve asset and liability holdings and on remittances of earnings to the Treasury, which capture the interest rate risk of these normalization policies. We show that under a baseline normalization strategy described by policymakers, the balance sheet should slowly return to a more normal composition and size, while remittances should remain sizable. With some alternative normalization plans, especially if faced with high interest costs, remittances could drop to zero for some time.

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[a] Federal Reserve Board

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