Unwinding the Fed's balance sheet

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There are very few examples of central banks rapidly building up assets on their balance sheets and then unwinding them.

So the Fed has $4.5 trillion of assets on its balance sheet. These are mostly mortgage-backed securities and Treasuries that had bought in the course of responding to the financial crisis, so in order to support the financial system, in order to support the real economy as we were coming out of the recession. There's been enough healing that the Fed is now comfortable starting to unwind that balance sheet. And what it's doing is it's not selling these assets, but as they mature, it's no longer reinvesting them.

The question for financial market participants is: Does it make those assets more expensive? From our perspective, the pace at which the Fed is displacing assets off the balance sheet at the moment is so slow, then the marginal impact on yields on rates is going to be very small as well.

It won't be completely inconsequential, but I think it's going to have a much smaller impact than the market currently anticipates.

The Fed is experimenting as it proceeds with the unwind, and one of the reasons they're going slowly is because there is that uncertainty around what the impact will be. They're very sensitive to creating volatility in interest rates, and, in fact, it's part of their mandate to not create volatility. So as they unwind this balance sheet, we're moderately confident that rates will not rise significantly because it's happening at a glacial pace.

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