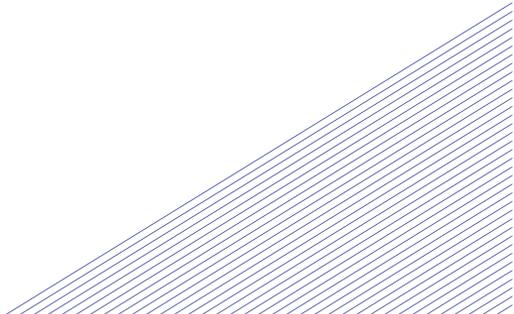


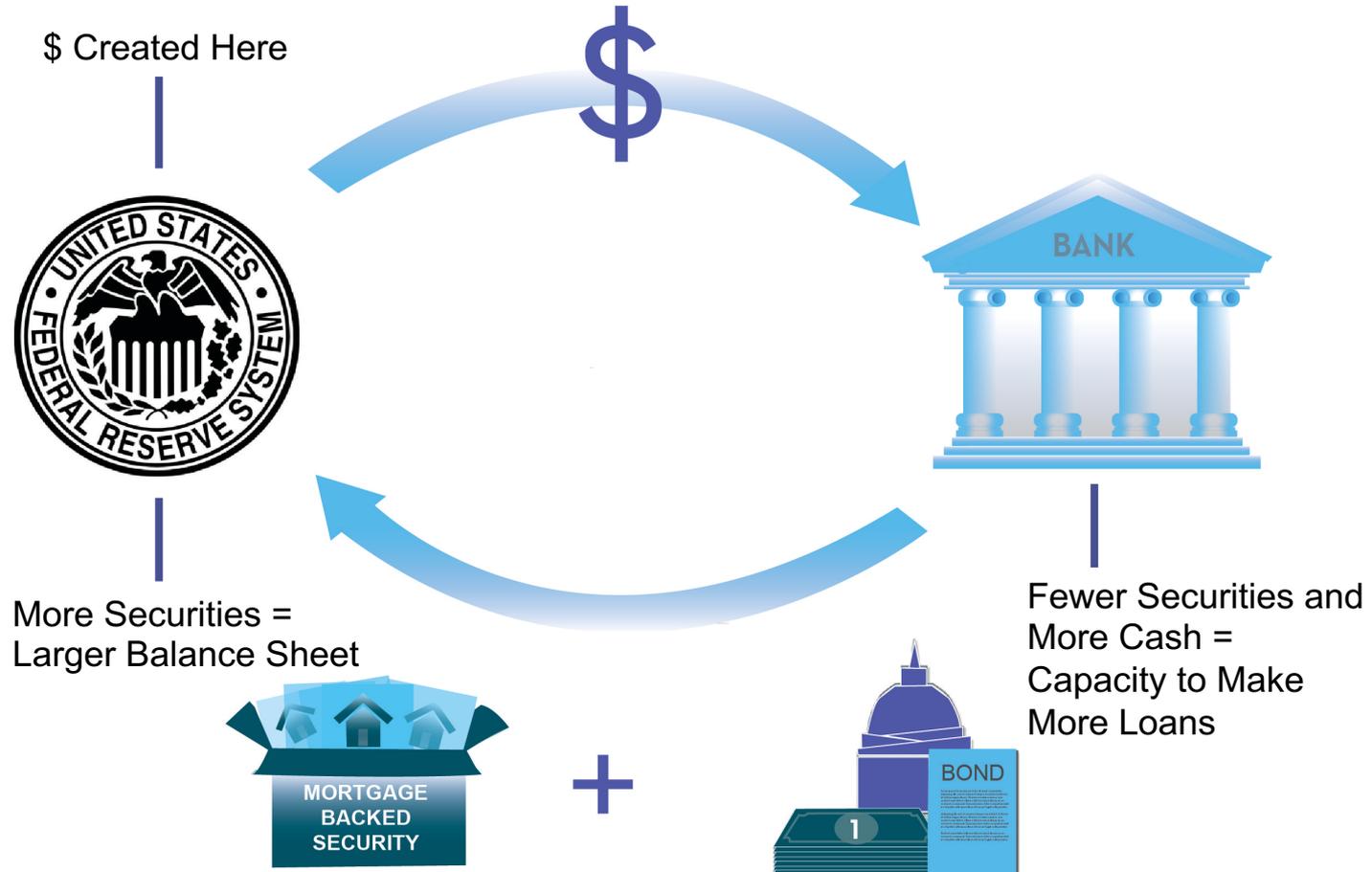
Shrinking the Federal Reserve's Balance Sheet

June 2017

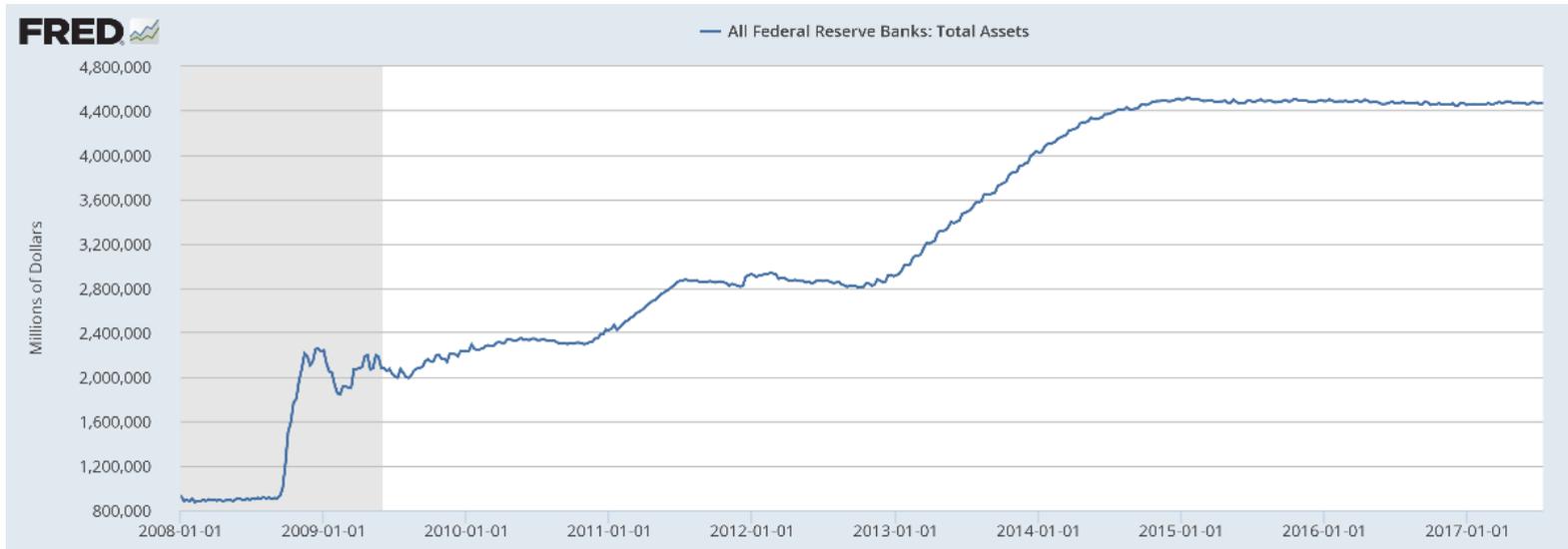
Cidel



Refresher on Quantitative Easing



What is on the Fed's Balance Sheet?

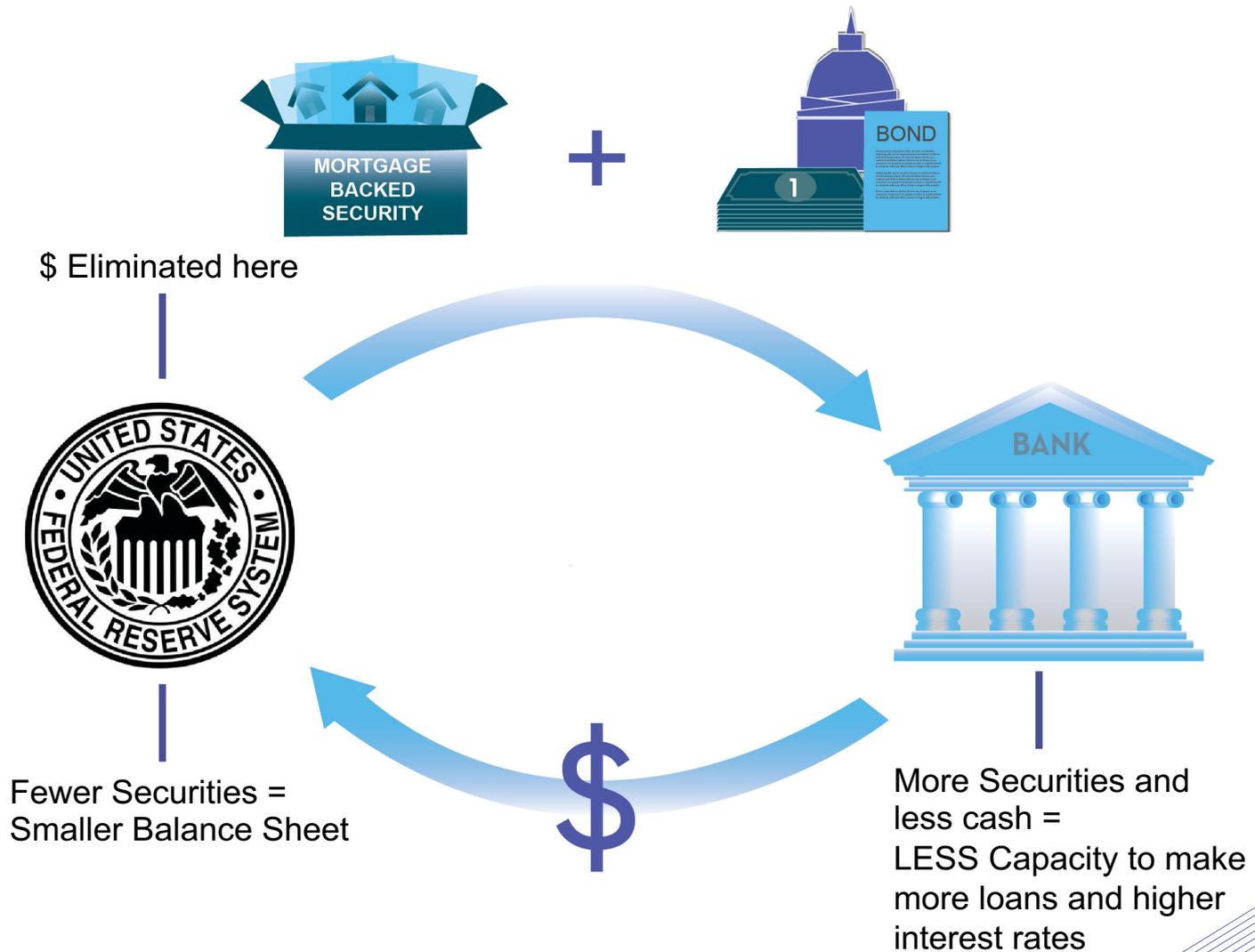


Source: Board Of Governors of the Federal Reserve System (US)
fred.stlouisfed.org

\$4.5 trillion in assets consisting of:

- 18% of the total treasury bonds outstanding.
- 25% of all the Mortgage Backed Securities in existence.

Unwinding the Fed's Balance Sheet

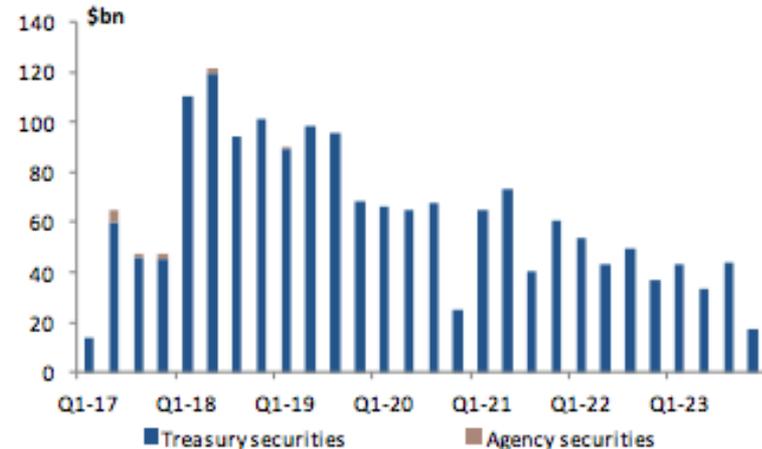


How will the Fed Choose to unwind its Balance Sheet?

Treasury and Agency maturities from the SOMA portfolio rise sharply in 2018 and 2019



A bulk of the Treasury maturities from the SOMA portfolio are over the next six years

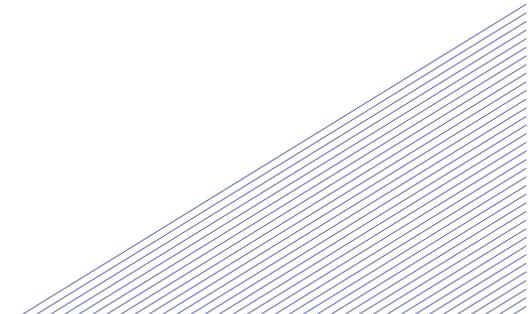


Source: SG Cross Asset Research

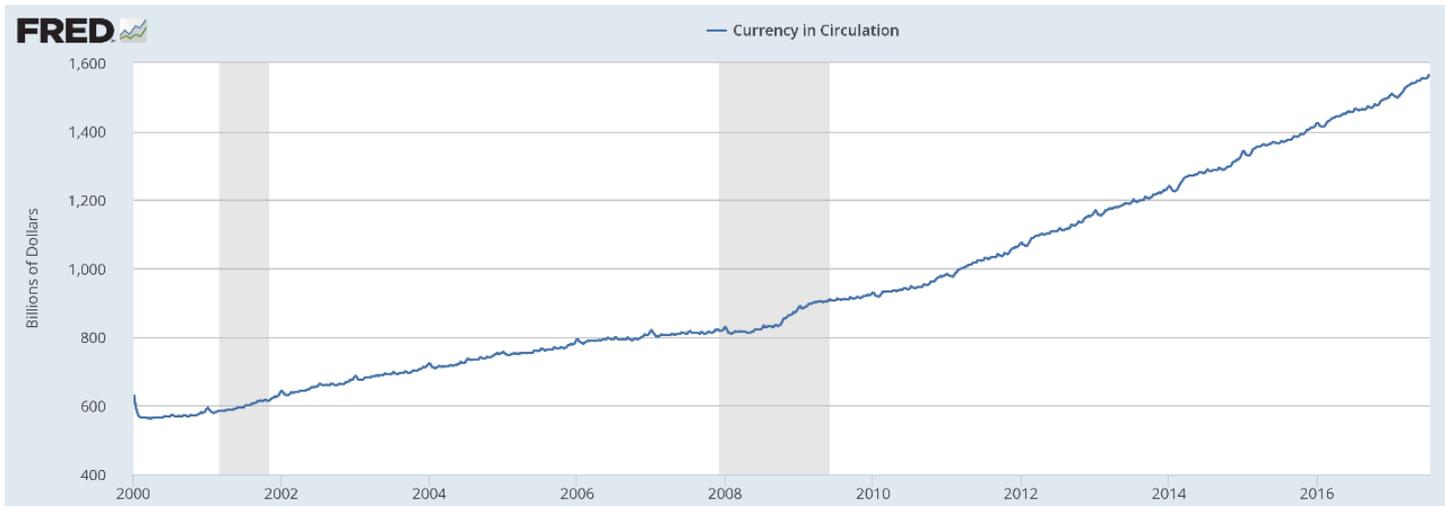
Goal is to be passive and predictable:

- Start slowly selling \$6 billion/month in treasuries and \$4 billion/month in Mortgage Backed Securities.
- Grow to \$40 billion/month.

Once the Fed starts it will not stop unless there is a major economic event.



How big Bill the Fed's Balance Sheet be in the future?

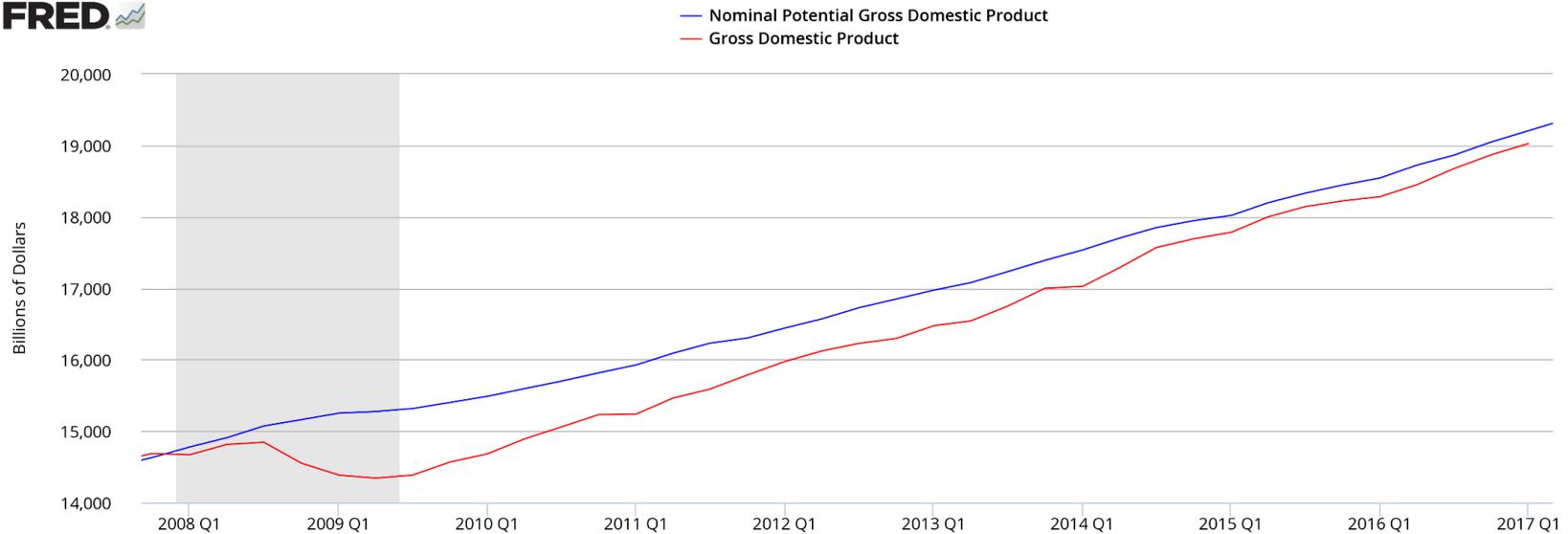


Source: Board Of Governors of the Federal Reserve System (US)
fred.stlouisfed.org

Before crisis the Fed's Balance sheet was \$800 billion:

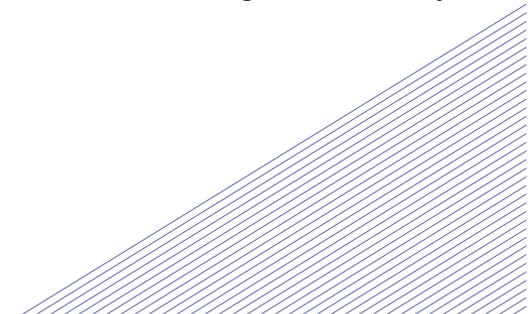
- As there is more currency in circulation now, the balance sheet should be 1.5 trillion today.
- Expect the balance sheet to stabilize at about \$2.5 trillion to match the current expected growth rate.
- Total amount to be sold into the market = \$2 trillion.
 - Four times the current annual fiscal deficit.
 - It will take upwards of 5 years to unwind.

When will the Fed start to reduce its Balance Sheet?

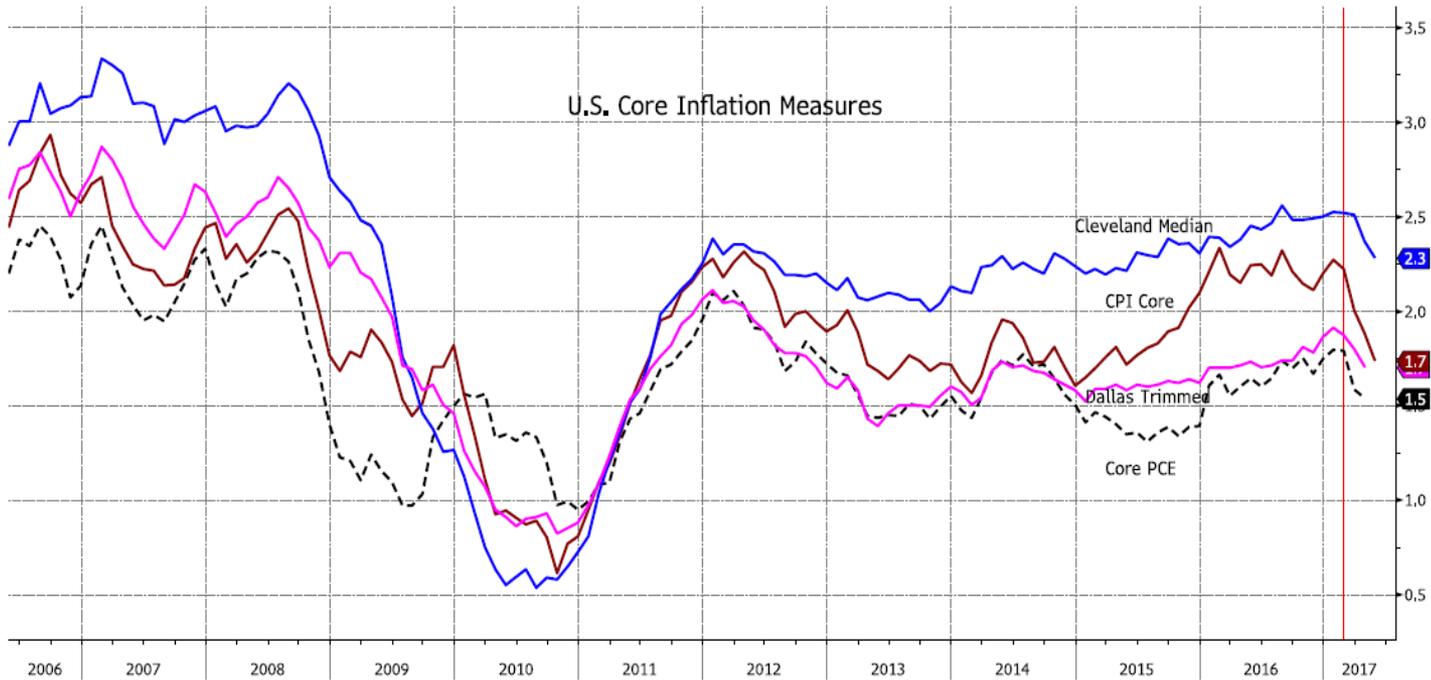


Source: BEA, CBO
fred.stlouisfed.org

The economy has still not closed the gap between GDP and potential GDP. This would argue for delay.



When will the Fed start to reduce its Balance Sheet cont'd?



Source: TD Bank

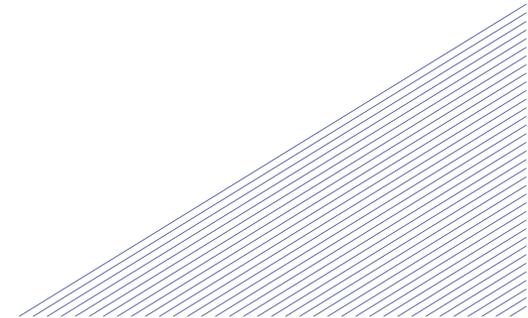
US measures of inflation are not growing. Another argument for delaying.

Biggest reason to start soon - Unemployment



Source: U.S. Bureau of Labor Statistics
fred.stlouisfed.org

Unemployment is at one of its lowest points in almost two decades.

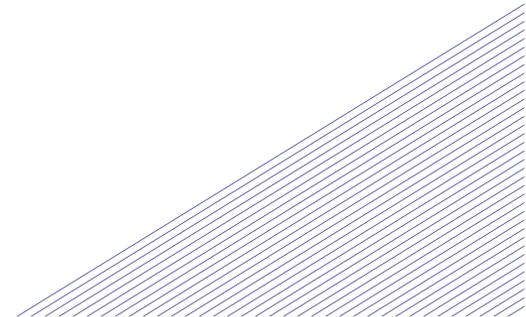


Shrinking the Fed's Balance Sheet

The technique of Quantitative Easing was new to all central banks, and so too will be the removal of QE. For this reason, the process will be slow and will take upwards of 5 years to complete.

The timing of shrinking the balance sheet is not ideal with lower inflation rates and the economy still below potential output. But the combination of low unemployment combined with likely appointment of a new Fed chair early in 2018 point to the Fed starting sometime this fall.

The net result will be to raise long term interest rates by about 4- 5 bps over what they would have been in the absence of the Fed's asset sales.



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