This Is Not What Transparency Looks Like

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The Fed is touting the transparency of their public review of how they conduct monetary policy, but they have suppressed one of the most critical pieces of information.

In August of 2012, just before the Fed embarked on QE3 (the flow-based asset purchase program), the Fed issued a working paper by Seth Carpenter and his staff that provided a forecast of its balance sheet, in January 2013 that paper was reissued to include projections of Fed income under different interest rate scenarios, and in September 2013 the paper was revised once again because QE3 was continuing longer than had originally been expected.

In 2014, projections of the Fed's balance sheet and income, which it remits to Treasury, were incorporated into the New York Fed's annual reports on open market operations that it released in June. In July 2017, the New York Fed issued an update of the projections it had released the month before to reflect the just-announced plan to shrink its balance sheet.

By providing these projections, the Fed continued its tradition of being highly transparent about its monetary policy. The size of the balance sheet and the implications for future Fed remittances to Treasury were critical consequences of the Fed's decision to engage in large scale asset purchase programs to stimulate the economy as well as the decisions of the Fed about how to unwind those purchases as the economy recovered. As a result, transparency about the balance sheet and income allowed Congress and the public to better understand the implications of the Fed's actions to facilitate the accountability that comes with the Fed's independence.

More recently, the Fed made, with little fanfare, the momentous decision that it would conduct monetary policy going forward using the large-balance-sheet approach it had been using since the crisis rather than the smaller-balance-sheet approach it had used previously. An important factor in that decision is, of course, just how big the balance sheet would have to be and the implications of that balance sheet for how much money the Fed would make, or lose, under different circumstances.

Currently, the Fed is engaged in a broad public review of the tools it uses to conduct monetary policy (as well as its strategy and communication practices). The tools include large scale asset purchases as well as the framework the Fed uses to implement policy in normal times.

Consequently, it is disappointing that the New York Fed's most recent annual report on open market operations, released in April, did not include projections of the balance sheet or income even though those projections had been included in the previous four reports. Instead, there is a note (page 3) stating that the projections would be provided later in the year when the Fed's balance sheet plans were finalized.

As described above, the Fed has previously shown itself perfectly willing to release projections and then release updates of those projections, but not this year, evidently. It is tempting to speculate that the Fed did not release the projections because it was uncomfortable with what they showed. Over the past year, there has been a sharp revision upward in the estimated size of the Fed's balance sheet that will be necessary to conduct monetary policy using its large-balance sheet approach. For example, the median respondent to the New York Fed's survey of large broker expected the Fed's balance sheet in 2025 to be $3.6 trillion as of June 2018 and $4.3 trillion as of June 2019. Partly as a result, it seems possible that current projections for net income could be negative under some interest rate scenarios now. Last year's projections showed a sharp drop in remittances to Treasury under a "higher rates" scenario. The current report indicates that the Fed's domestic portfolio has already shifted from having unrealized net gains to having unrealized net losses. The combination of a larger balance sheet and more embedded losses could combine to create an unflattering projection for future earnings.

It is unfortunate that the Fed has withheld these projections precisely when it is seeking feedback from the public about how it is conducting, and plans to conduct, monetary policy because the projections are important pieces of information for weighing the advantages and disadvantages of different approaches. (For more information see "Understanding the Fed's implementation framework debate".) Moreover, two of the most problematic aspects of the large-balance-sheet approach to implementation are the uncomfortable optics of making large interest payments to banks and the potential to lose a lot of money if interest rates go up. If the Fed is already so concerned about its balance sheet and income outlook that it is suppressing the projections, perhaps it should reconsider and instead return to the smaller-balance-sheet approach to implementation it had used effectively before the crisis.