Federal Reserve plans on a 'predictable' winddown of its $9T in asset holdings

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The nation's central bank fleshed out more details on how it may undo the trillions of dollars in asset purchases it carried out during the COVID-induced economic downturn.

The Federal Reserve on Wednesday released minutes from its March 15 and 16 meeting, which details conversations among top central bank officials suggesting that the Fed will soon start the process of shrinking its $9 trillion balance sheet.

"Participants reaffirmed that the Federal Reserve's securities holdings should be reduced over time in a predictable manner," the minutes noted. The Fed has yet to officially vote on exactly how to carry the process out, although it could begin as soon as next month.

The U.S. economic shutdown pushed Fed Chairman Jerome Powell to a stance of aggressively easy monetary policy, which involved near-zero short-term interest rates and a slew of emergency lending programs. Another major policy: the resurrection of the Great Financial Crisis-era program known as “quantitative easing,” in which the Fed snatches up assets to signal its support to financial markets.

For two years, the Fed bought over $4 trillion in assets, mostly focused in U.S. Treasuries and agency mortgage-backed securities.

The purchases finally stopped last month, as the Fed pivoted to a stronger stance against rising inflation. Price increases at a yearly pace unseen since the early 1980s has spurred Fed officials into supporting a faster drawback in its exceptionally easy money policies.

That involves not only raising short-term interest rates, but a reduction in its balance sheet (a process also referred to as “quantitative tightening”).

In the March meeting, Fed staffers presented policymakers with possible options for how to carry out the process. The minutes showed that the top Fed officials “generally agreed” on monthly caps of about $60 billion for Treasury securities and $35 billion for agency mortgage-backed securities.

The Fed says the caps would be "phased in over a period of three months or modestly longer if market conditions warrant."

That would be a faster pace than the Fed’s last attempt at shrinking the balance sheet. At the peak of the Fed’s efforts (from 2017 to 2019) to shrink its holdings, it topped out its monthly wind down at a pace of $30 billion monthly pace for Treasuries and $20 billion monthly pace for agency mortgage-backed securities.

The central bank emphasized it could be flexible and “adjust any of the details of its approach to reducing the size of the balance sheet in light of economic and financial developments.”

One difference between this process and the last: the Fed’s purchases this time around involved more shorter-dated Treasuries than its post-2008 financial crisis purchases.

The Fed’s outline from the March meeting suggests the Fed will likely allow T-bills (among the shortest-duration securities) to make up a large part of the monthly reductions.

On mortgage-backed securities, the Fed said it could consider a more aggressive rolloff process (via actively selling its holdings).

“A Committee decision to implement a program of agency MBS sales would be announced well in advance,” the minutes read.

On Tuesday, Fed Governor Lael Brainard said the actual process could begin “as soon as our May meeting,” adding that she expects the process to be carried out “considerably more rapidly” than the last recovery.

The meeting will take place on May 3 and 4.

Brian Cheung is a reporter covering the Fed, economics, and banking for Yahoo Finance. You can follow him on Twitter @bcheungz.

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