THE FEDERAL RESERVE SYSTEM

Date: March 7, 2019

To: Federal Open Market Committee

From: Thomas Laubach and Simon Potter

Subject: Attached Memo on Options for Ending Balance Sheet Runoff and Proposed Statement of Balance Sheet Normalization Principles and Plans

At the upcoming meeting, the Committee will discuss plans for the completion of the normalization of the size of the balance sheet. Today we are distributing the attached memo on the near-term plan for completing the normalization of the size of the balance sheet together with a set of bullets that could form the basis for a communication on balance sheet normalization plans after the upcoming meeting. Key elements of this plan include: (i) an option to taper the redemption of Treasury securities beginning in April; (ii) the conclusion of the reduction in the size of the SOMA portfolio at the end of September; (iii) reinvestment of principal payments on agency debt and agency MBS holdings after September in Treasury securities across the maturity spectrum; (iv) retention of the existing cap on agency debt and agency MBS redemptions so that any principal payments in excess of $20 billion would be reinvested in agency MBS; (v) an indication that the size of the balance sheet would likely be held roughly constant for a time after September and that the level of reserves would gradually decline over this period to a level consistent with efficient and effective policy implementation. We plan to distribute a second memo on Friday that is focused on determining the longer-run level of reserves consistent with efficient and effective policy implementation.

As with the Statement Regarding Monetary Policy Implementation and Balance Sheet Normalization issued in January, the Chairman would like to issue the proposed statement on balance sheet normalization principles and plans with the support of all FOMC participants. To that end, we would welcome any comments you might have on the attached draft bullets. Please submit any comments you might have through FOMC Portal comments by COB on Monday, March 11. We will revise the statement based on your comments and distribute an updated draft statement next week.

DRAFT: Balance Sheet Normalization Principles and Plans

In light of its discussions at previous meetings and the progress in normalizing the size of the Federal Reserve's securities holdings and the level of reserves in the banking system, all participants agreed that it is appropriate at this time for the Committee to provide additional information regarding its plans for the size of its securities holdings and the transition to the longer-run operating regime. At its January meeting, the Committee stated that it intends to continue to implement monetary policy in a regime in which an ample supply of reserves ensures that control over the level of the federal funds rate and other short-term interest rates is exercised primarily through the setting of the Federal Reserve's administered rates and in which active management of the supply of reserves is not required. The Statement Regarding Monetary Policy Implementation and Balance Sheet Normalization released in January as well as the principles and plans listed below together revise and replace the Committee's earlier Policy Normalization Principles and Plans.

- To ensure a smooth transition to the longer-run level of reserves consistent with efficient and effective policy implementation, the Committee intends to slow the pace of the decline in reserves over coming quarters provided that the economy and money market conditions evolve about as expected.
    - [The Committee will slow the reduction of its holdings of Treasury securities by reducing the cap on monthly redemptions from the current level of $30 billion to $20 billion beginning in April, and to $10 billion beginning in July.]
    - The Committee will conclude the reduction of its aggregate securities holdings in the System Open Market Account (SOMA) at the end of September 2019.
    - The Committee will continue to allow its holdings of agency mortgage-backed securities to decline, consistent with the aim of holding primarily Treasury securities in the longer run.
        - Beginning in October 2019, principal payments received from agency debt and agency mortgage-backed securities will be reinvested in Treasury securities subject to a maximum amount of $20 billion per month; any principal payments in excess of that maximum will continue to be reinvested in agency mortgage-backed securities. It continues to be the Committee's view that limited sales of agency mortgage-backed securities might be warranted in the longer run to reduce or eliminate residual holdings. The timing and pace of any sales would be communicated to the public well in advance.

    - Reinvestment of principal payments from agency MBS will be invested in Treasury securities across a range of maturities to roughly match the maturity composition of Treasury securities outstanding.

- The average level of reserves after the FOMC has concluded the reduction of its aggregate securities holdings at the end of September will likely still be somewhat above the level of reserves necessary to efficiently and effectively implement monetary policy.

    - In that case, the Committee currently anticipates that it will likely hold the size of the SOMA portfolio roughly constant for a time. During such a period, persistent gradual increases in currency and other non-reserve liabilities would be accompanied by corresponding gradual declines in reserve balances to a level consistent with efficient and effective implementation of monetary policy.

- When the Committee judges that reserve balances have declined to this level, the SOMA portfolio will hold no more securities than necessary for efficient and effective policy implementation. Once that point is reached, the Committee will begin increasing its securities holdings to keep pace with trend growth of the Federal Reserve's non-reserve liabilities and maintain an appropriate level of reserves in the system.