

Fed Off to Slow Start Unwinding Billions in Mortgage Assets

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The Federal Reserve, which responded to the financial crisis with unprecedented monetary policy, is off to a slow start in settling mortgage assets it bought from government-sponsored enterprises, according to Federal Reserve Bank of Cleveland (FRBC) vice presidents John Carlson and Joseph Haubrich and research assistant John Linder.

Forget the target range for the federal funds rate as the Fed's primary weapon; the Fed's balance sheet became a "crucial" policy tool in managing the latest crisis, they wrote in [commentary today](#). Before the Fed had reduced the rate effectively to zero — or 0-0.25% to be precise — it launched a series of large-scale asset purchase programs.

In November 2008, the Fed announced its \$500m mortgage-backed securities (MBS) purchase program, which was expanded to \$1.25trn in March 2009. The Fed bought agency MBS and debt securities from Freddie Mac, Fannie Mae and Ginnie Mae.

The program started as a way for the Fed to reduce the cost and increase the availability of credit for house purchases, the FRBC said. Additionally, the program was also associated with a drop in mortgage-related interest rates.

But the program had another byproduct, the FRBC noted, as excess reserves swelled to more than \$1trn from around \$2bn, the average for much of the previous decade:

The Fed [wrapped up agency MBS purchases in March 2010](#) and since then has followed a policy of redeeming agency debt or MBS that have matured or prepaid. But this current policy will lead to a slow diminishing of the balance sheet, the FRBC noted.

For example, as principal and interest payments are made, an equal reduction in reserves occurs — making for a very slow shrinking of the balance sheet.

The FRBC noted in a separate e-mail that, as the Fed works to settle its MBS purchases, the trend in agency debt purchases has been one of steady decline since the program's expiration. The balance of those purchases peaked at \$175bn and then fell back below \$160bn:

Additionally, the method for reducing the Fed's balance sheet will depend on market conditions, the FRBC said. For example, the Federal Reserve Bank of New York in June announced plans to swap \$9.2bn of MBS coupons.

Analysts said at the time the rationale behind the swaps was a "relatively short supply" of Fannie 5.5% coupons. In a single week, the FRBNY sold \$6bn of Fannie 5.5s and swapped those coupons for \$4bn of Fannie 4.5s and \$2bn of Freddie 4.5s.

In terms of settling the MBS purchases, the FRBC noted there were no coupon swap or dollar roll operations this week.