

When Will The Fed Shrink Its Balance Sheet? In The Long Run The Fed's Balance Sheet Will Probably Grow.

Analgesics are addictive. Since interest rates were deployed to manage the economic cycle we have seen the Fed Funds Target Rate decline, making lower lows and lower highs (1980, 1984, 1989, 1995, 2000, 2007) as the Fed has been repeatedly enlisted in the bailout of asset markets and the economy.

Now that a new policy tool has been invented it will doubtless be counted upon to support further crises and excesses. This is the nature of moral hazard. We cannot un-discover QE.

With Fed Funds at 0.25% there is no room for cutting it any further. We will be fortunate when the Fed finds itself in a position to reset its policy tool higher but should another crisis or recession occur, with Fed funds at these low levels, the Fed's balance sheet can and will be deployed. While the balance sheet may shrink in the next 7 to 8 years, one can reasonably expect it to expand over a longer time frame.