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Yesterday and today, Fed Chair Jay Powell appeared before the US House and Senate for the semi-annual Humphrey-Hawkins testimony, an update on the economy and Fed policy required by law since 1978. **In his commentary, Chair Powell reiterated the likelihood of policy easing later this year, tacitly acknowledging the political minefield of the timing by stating that Fed officials would "keep our heads down" in a highly charged US Presidential election year.**

While the semi-annual testimony remains an important exercise, the line of questioning from elected officials has historically migrated into political theater, a temptation that is especially evident in an election year where former President Donald Trump has publicly questioned the appropriateness of policy easing in the months preceding an election (Trump on Feb 2nd: "I think [Chair Powell] is going to do something to probably help the Democrats" and that he would not reappoint "political" Fed Chair Jay Powell)

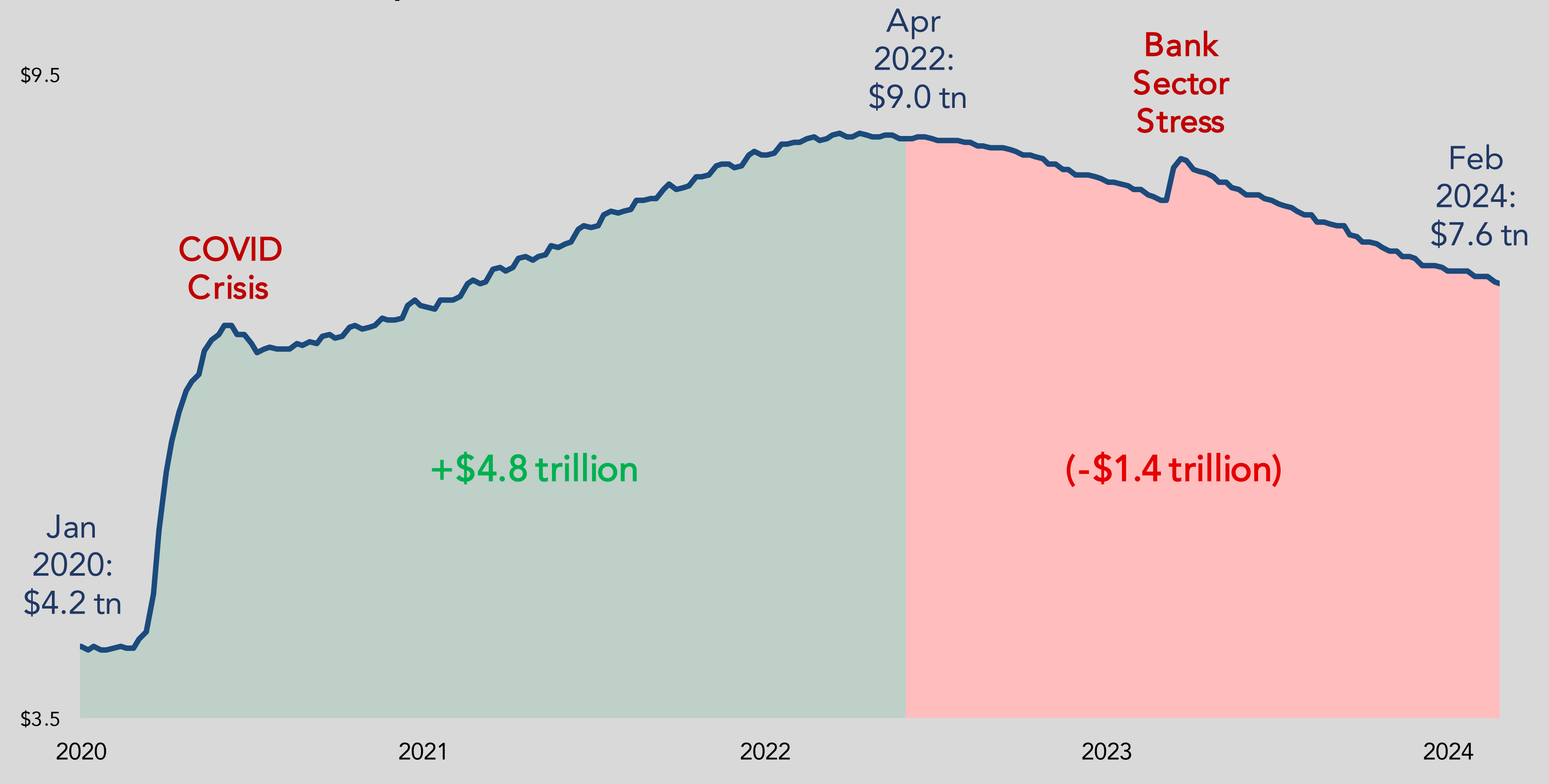
In the first two years of the COVID crisis, the Fed accelerated its extraordinary policy easing by more than doubling its balance sheet from $4.2 trillion in Jan 2020, to a peak of nearly $9 trillion in Apr 2022. Since then, the Fed has hastened the pace of policy tightening by reducing the size of its balance sheet by $1.4 trillion in aggregate, or $95 billion per month ($60 bn USTs and $35 bn MBS per month).

Quantitative tightening (QT) is essentially the opposite of quantitative easing (QE), and entails an exercise whereby the Fed effectively removes trillions of dollars of excess cash from the financial system. **The Fed implements QT through a series of operations whereby they allow UST and MBS securities to mature without replacing them, effectively triggering "payment" from the US Treasury by reducing the cash balance they keep on deposit with the Fed**. The US Treasury, in turn, funds these payments by issuing new UST securities to private sector investors, thereby draining liquidity from the financial system.

As disinflation progresses in the year ahead, the US economy will likely require policy easing in the 2H of 2024 (rate cuts and QT deceleration) as the Fed's current policy stance becomes increasingly restrictive; however, doing so concurrent with a US Presidential election cycle will become a complex political balancing act for the Fed. **While the Fed has not provided any guidance on the timing and scope of potential QT deceleration, some have suggested a potential initial slowdown in the monthly pace of QT by mid year from the current $95 bn per month** ($60 bn USTs, $35 bn MBS) **to $65 bn per month** ($30 bn UST, and MBS left unchanged at $35 bn).

Over the last two years, the Fed has accelerated the pace of policy tightening by reducing the size of its balance sheet by $1.4 trillion in aggregate, or $95 billion per month ($60 bn USTs and $35 bn MBS per month). As disinflation progresses in the year ahead, the US economy will likely require policy easing in the 2H of 2024 (rate cuts and QT deceleration) as the Fed's current policy stance becomes increasingly restrictive; however, doing so concurrent with a US Presidential election cycle will become a complex political balancing act for the Fed.

Fed balance sheet assets, USD tn



Source: (1) Federal Reserve Board. Bloomberg. Data as of March 7, 2024.

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"Macro stability isn't everything, but without it, you have nothing."