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INSIGHT

Why Is the Federal Reserve Operating at a Loss?

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The Federal Reserve (Fed) is self-funded and normally earns more income than needed to cover its expenses and capital transfers, remitting the difference to Treasury. For 2022, the Fed remitted $76 billion. However, since September 2022, the Fed's expenses exceeded its income by $18.8 billion, causing remittances to temporarily cease. Depending on future interest rates, net income could remain negative for the next couple of years, and remittances could cease for longer. This Insight explains why this occurred and what it means for policy.

Why Did the Fed Suffer Losses? How Long Will They Continue?

As a result of its monetary policy operations, the Fed holds $8.4 trillion in Treasury and mortgage-backed securities (MBSs) on its balance sheet. The Fed earns income on these securities, which, along with other income and fees it charges, are used to finance its operating expenses and the interest paid on bank reserves and reverse repurchase agreements (reverse repos), two of its main liabilities. The difference between income and expenses is called net income, similar to profits. Net income is used exclusively to (1) pay statutorily required dividends to shareholders and (2) increase the Fed's surplus when it is below its statutory cap. The remainder is transferred to the Treasury (called remittances), where it is added to the federal government's general revenues. Remittances do not affect federal spending levels, so they effectively make the budget deficit and federal debt smaller than they otherwise would be.

The Fed's balance sheet consists mostly of longer-term assets and very short-term liabilities. Typically, longer-term assets have higher yields than short-term liabilities do, so net income is positive. But net income has been negative since September 2022 because interest rates rose sharply in 2022. Thus, the interest rate it pays on bank reserves and reverse repos—currently over 4%—became higher than the yield on securities acquired when interest rates were much lower. Interest income rose in 2022, but interest expense rose more—from $5.7 billion in 2021 to $102.4 billion 2022. The Fed acquired large holdings of low-yielding securities through quantitative easing (QE) to support the economy during the pandemic. For example, at the end of 2021, over 70% of its MBS holdings were issued in 2020 or 2021, and 70% had coupon rates of 2.5% or lower.

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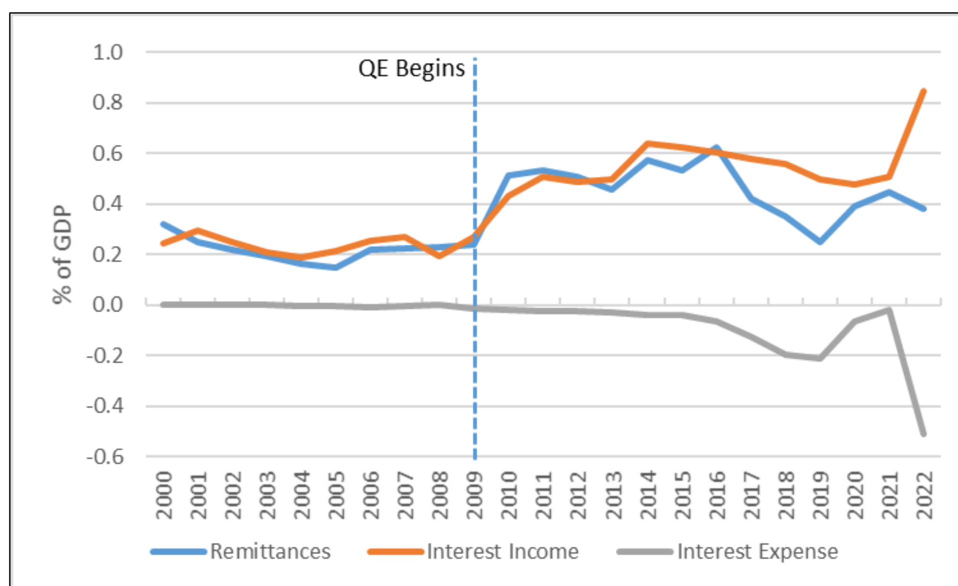
If remittances are zero in 2023, it will be the first year that has happened since 1934. (In some years, remittances were statutorily required. In years with no statutory requirement, remittances were the result of positive net income.) The yield on the Fed's assets will eventually exceed the yield on its liabilities again because short-term interest rates will fall or low-yielding assets on the Fed's balance sheet will eventually mature and be replaced by higher yielding assets. At that point, net income will become positive again, but projections suggest that may take a few years. Short-term interest rates are unlikely to fall significantly until inflation becomes low again. (So long as the Fed continues to hold its securities to maturity, as planned, the Fed will not realize any losses through sales of these securities.)

How Do Current Losses Compare to Past Remittances?

Although Fed losses will reduce federal revenues, any temporary losses would be expected to be more than offset by unusually large remittances from 2009 to 2022 (see **Figure 1**). Beginning in 2009, its net income and remittances increased significantly as a result of its balance sheet growth caused by QE and low short-term interest rates on its liabilities. Between 2009 and 2022, annual remittances have been between $47 billion and $117 billion each year. Before 2009, the largest annual remittance ever was $35 billion. Moreover, this considers only the direct effect of QE on the federal budget. If QE returned the economy to full employment faster, that also had a positive indirect effect on the federal budget.

Figure 1. Fed Interest Income and Expenses and Net Remittances

2000-2022 (Projected)



Source: CRS calculations, Congressional Budget Office.

Will the Fed Go Bankrupt or Need to Be Bailed Out?

Private companies hold capital to prevent losses from causing insolvency. Losses do not affect the Fed's ability to honor its liabilities (as with a private company), and its creditors cannot compel it to declare bankruptcy when losses exceed capital.

Partly because of the statutory limit on its surplus, the Fed holds very little capital relative to its liabilities, and losses since September 2022 have been larger than its entire surplus. But unlike a private company, the Fed does not reduce its capital, become insolvent, or require a capital infusion to maintain solvency in

response to losses. Instead, under its accounting conventions, it registers the losses as a deferred asset. Positive net income in future years would be directed to eliminating this deferred asset instead of being remitted to Treasury. Thus, positive net income will resume before remittances.

Implications and Options

The Fed is not profit-maximizing—its remittances are a byproduct of monetary policy, not the metric to judge the success of monetary policy. Losses are a sign not of mismanagement but that its interest-bearing liabilities had higher yields than its interest-bearing assets. If the Fed based monetary policy on concerns about its profits and losses, it would detract from achieving its statutory mandate of maximum employment and stable prices. (If the Fed reverted to its pre-2008 framework for conducting monetary policy, average profits would be lower but losses would be less likely, however.)

Nevertheless, losses might have political implications—notably for the Fed's independence—or, if misunderstood, could negatively affect market or public confidence in the Fed. If Congress were concerned about the Fed's financial position or how it is perceived, it could consider reversing statutory reductions in the Fed's surplus (which were "pay fors" in unrelated bills). Or Congress could eliminate the Fed's surplus, as it is not used to absorb losses. Alternatively, H.R. 8918 from the 117th Congress would have terminated the Fed's financing of the Consumer Financial Protection Bureau's budget until the Fed deferred asset was eliminated.

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