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Weekly Commentary

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The rollout of the roll off

Last week, at the start of June, the Federal Reserve began to allow Treasuries and agency mortgage-backed securities to roll off its balance sheet, one that has risen to the colossal height of $9 trillion since the onset of the pandemic. Just as it bought these securities to flood the market with money (quantitative easing), the Fed essentially is removing liquidity (quantitative tightening). Liquidity provides a good visual because the process is akin to turning off a water spigot. Actually, more like closing a fire hose. The amount of securities whose proceeds will not be reinvested starts at $47.5 billion a month in June, July and August, rising to $95 billion monthly thereafter. That's a lot even in the face of $9 trillion.

The Fed has projected it will cull its holdings to around the level they were prior to the pandemic, but nothing is set in stone. The goal is to significantly reduce inflation, which even with rate cuts will not come easily.

While evidence is rising that the tightening cycle is already slowing the economy, the May jobs report, released Friday, showed the labor market remains hot. Payrolls increased by 390,000 across the country, indicating the economy has not pulled back much. Increased wages stemming from the high demand for workers will only add to the general inflation. The next three months will say a lot about the how effective the Fed's actions are at normalizing the economy.

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