

FEDERAL RESERVE BANK OF KANSAS CITY

U.S. Economic Outlook

October 15, 2024

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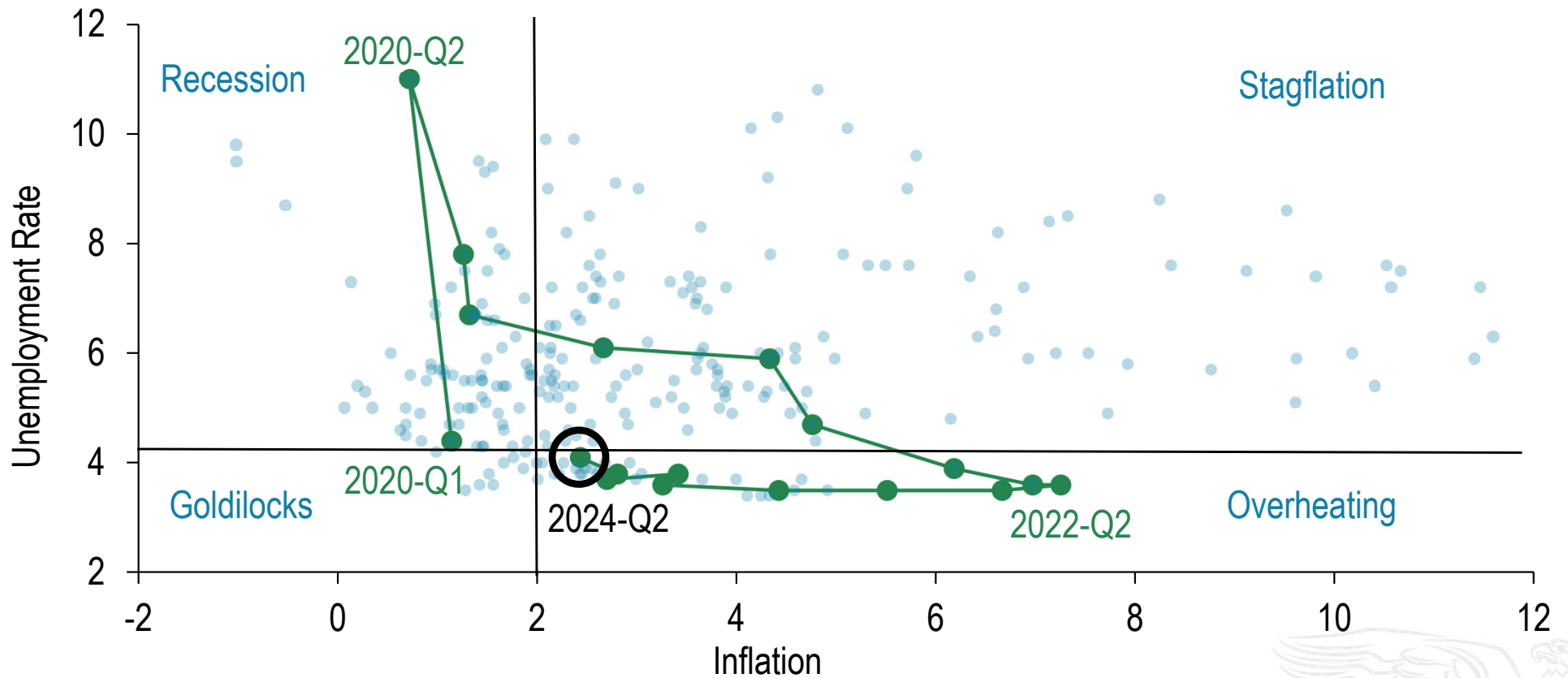


U.S. Economic Outlook

- The economy has made good progress towards the Federal Reserve's dual mandate objectives.
- Looking ahead, inflation is expected to move closer to 2 percent and unemployment is expected to remain low.
- As the economy normalizes from the pandemic, there are a range of views on where interest rates will settle.
- And there is considerable uncertainty regarding how much further the Fed can reduce its balance sheet.

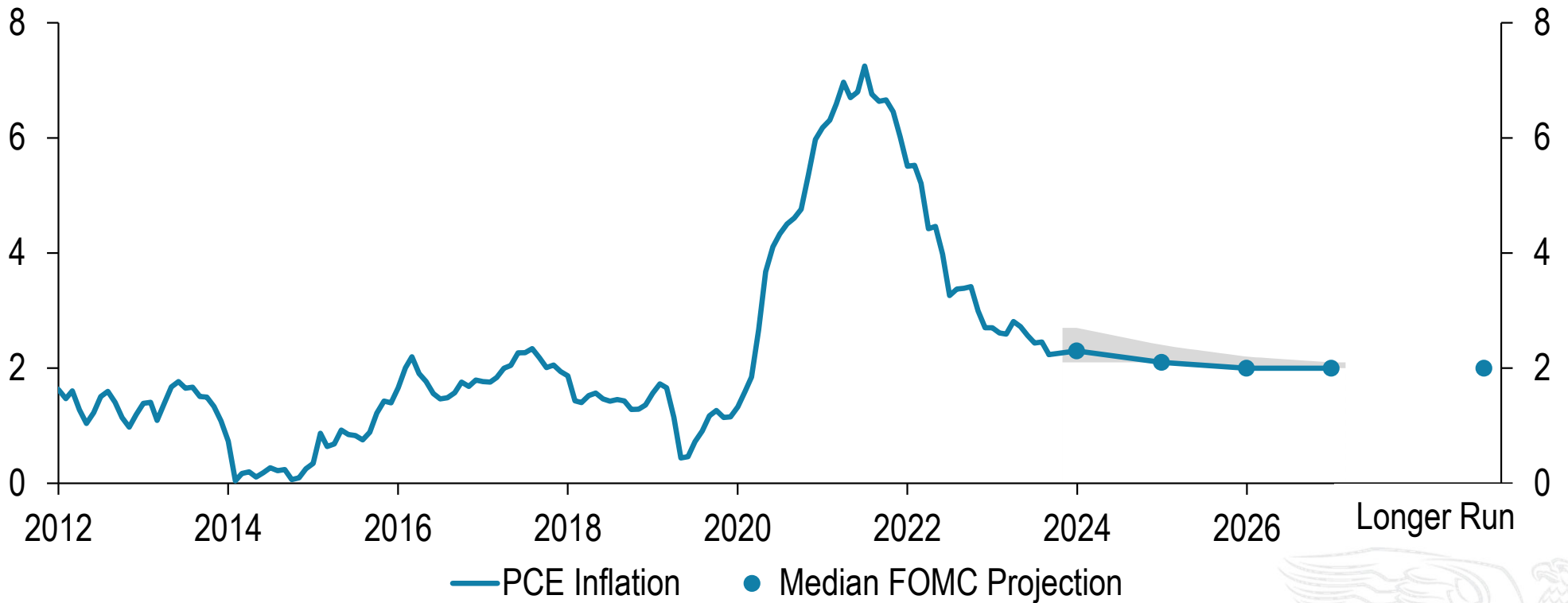


The economy has made good progress towards the Fed's dual mandate

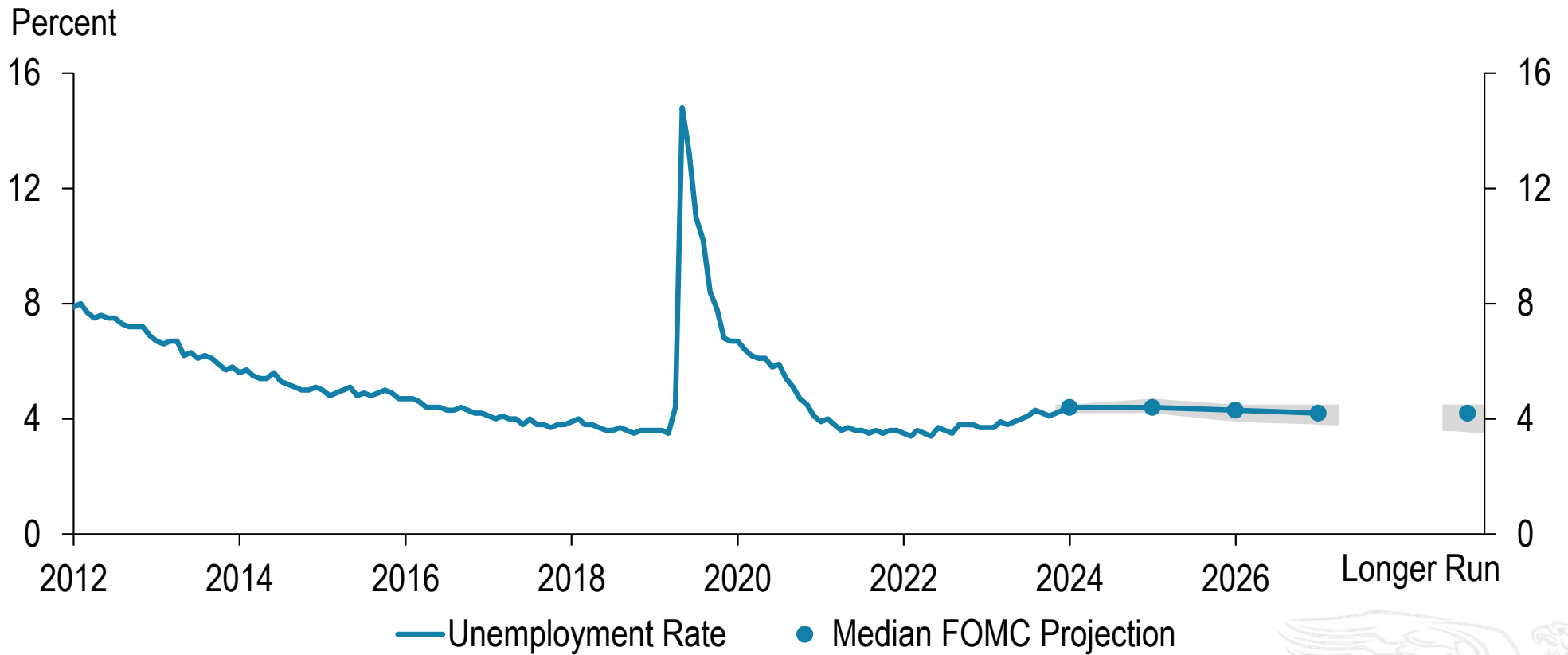


Inflation is expected to move closer to the 2 percent target

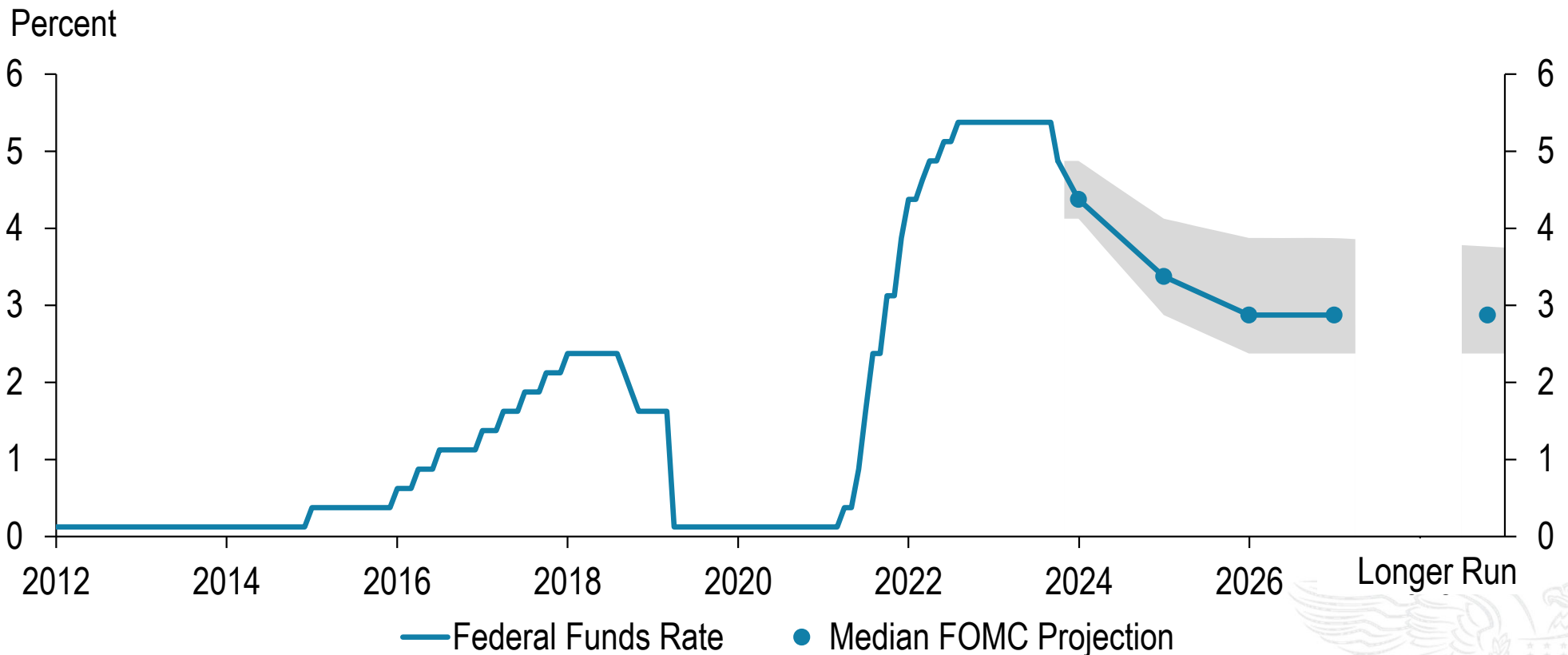
12-Month Percent Change



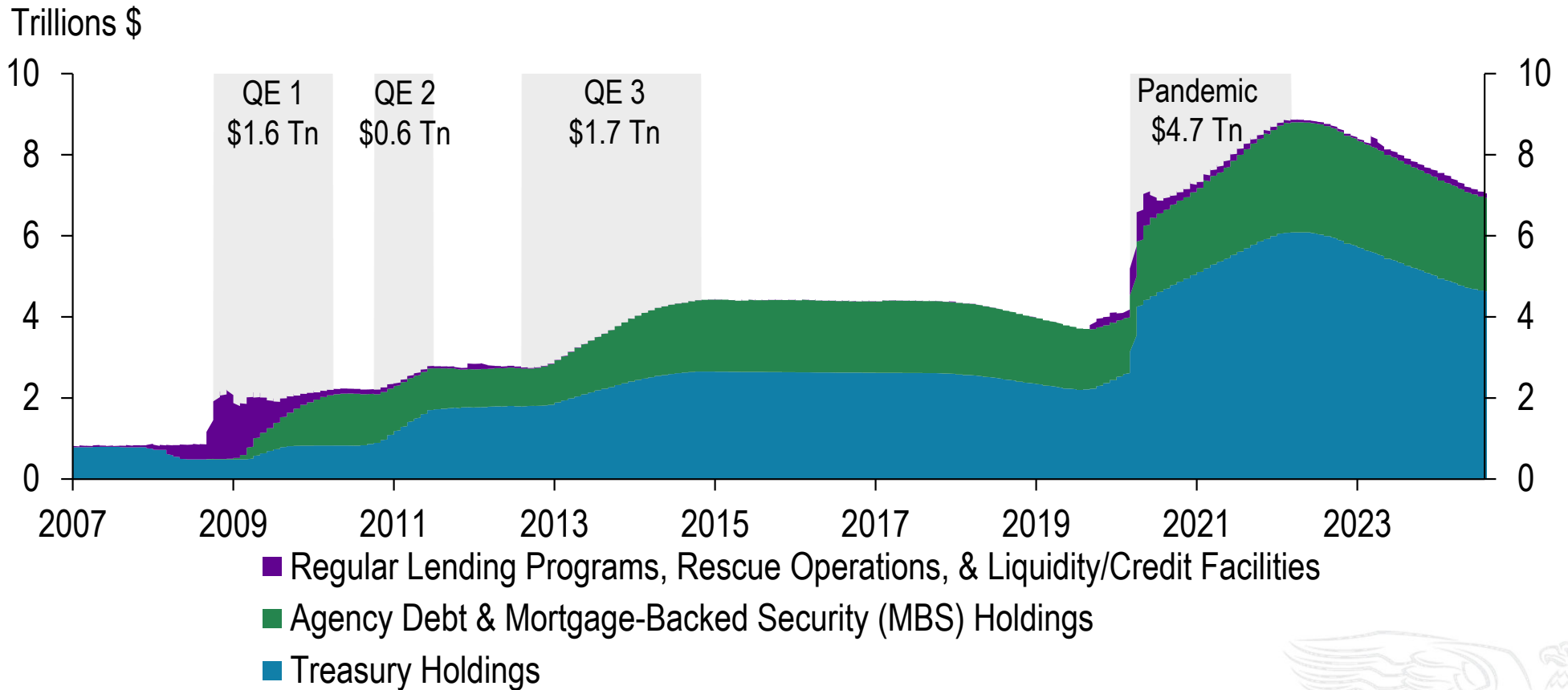
The unemployment rate is expected to remain low



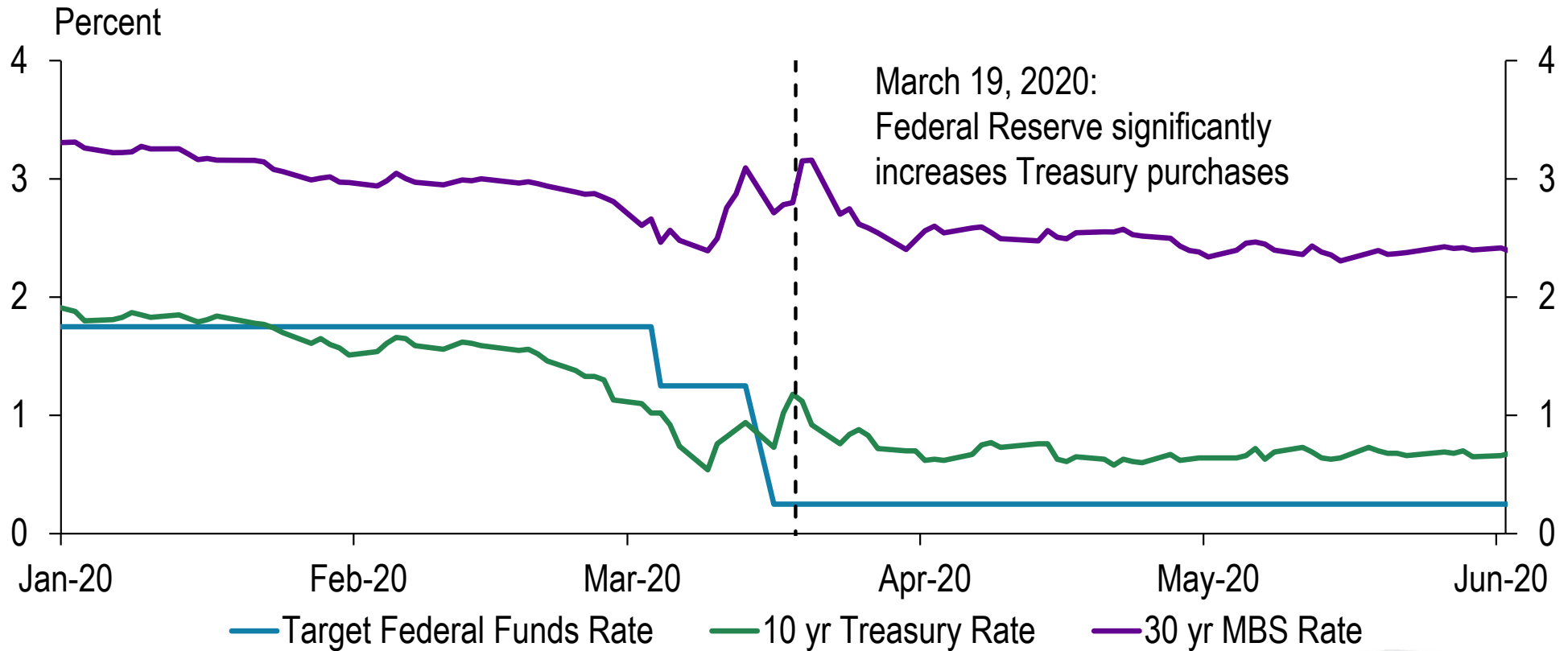
The FOMC expects further reductions in the funds rate, but there are a wide range of views on where interest rates will settle



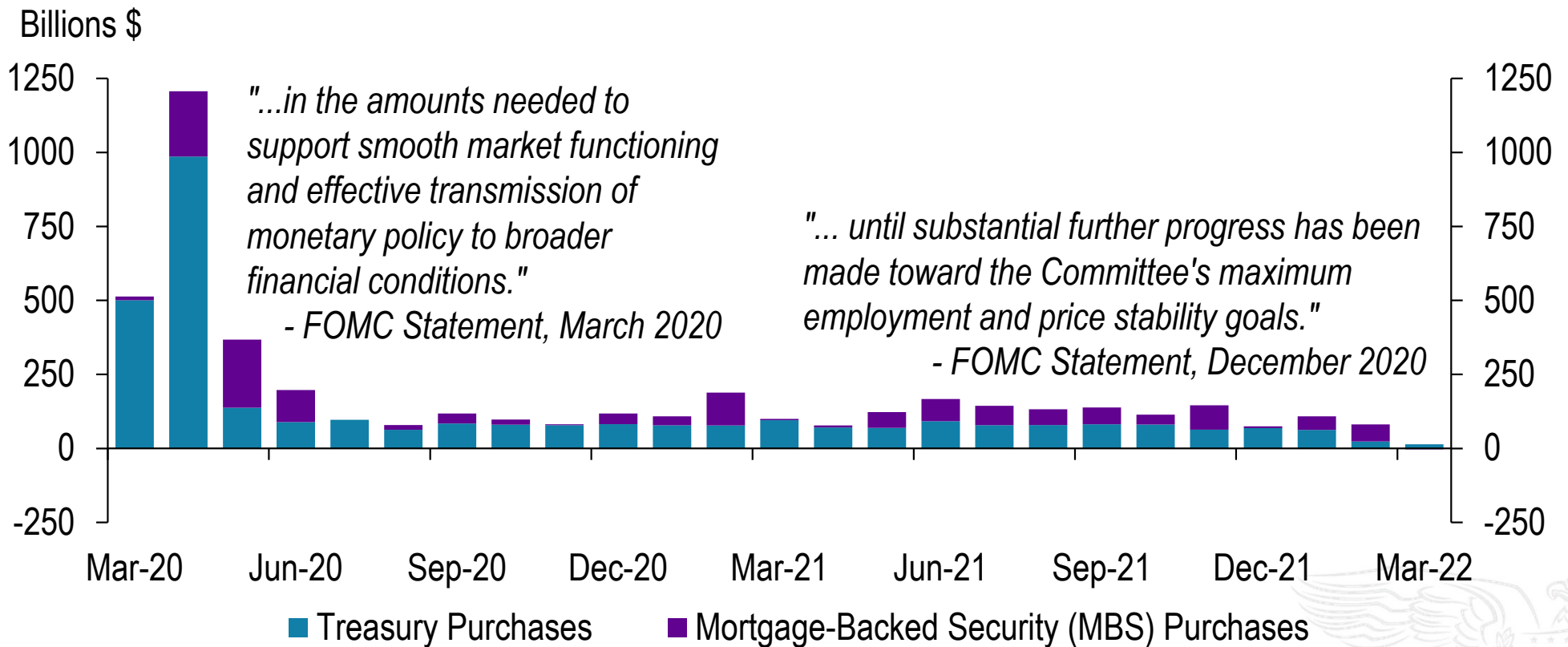
The Fed's balance sheet significantly expanded during the pandemic



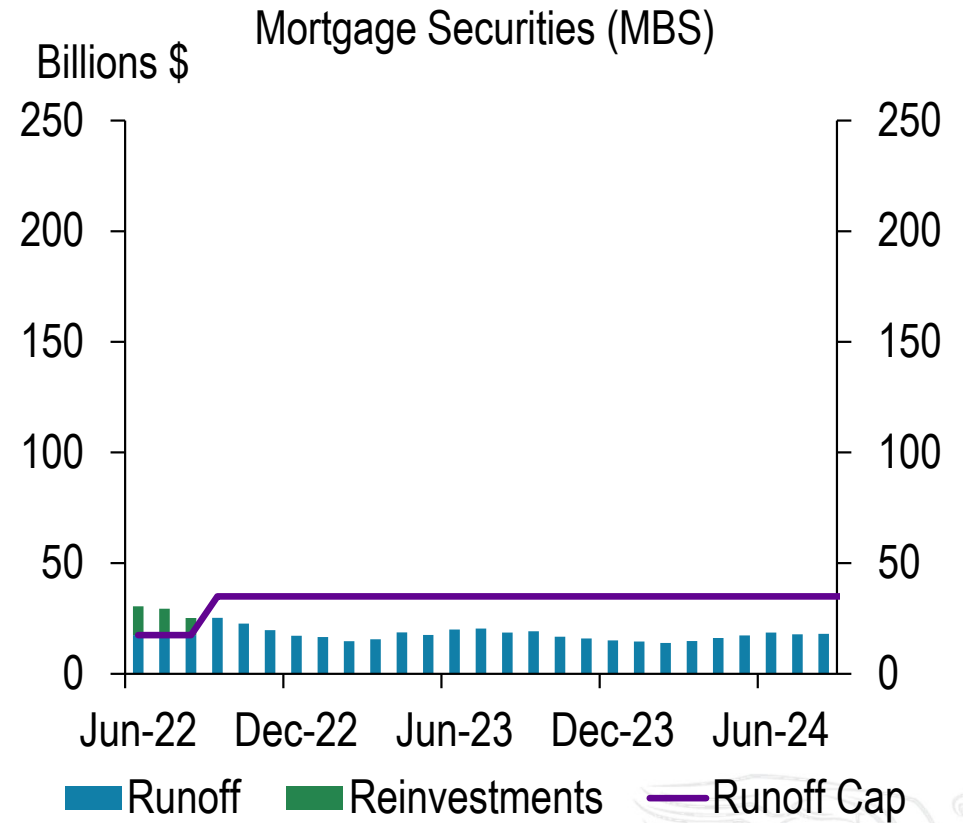
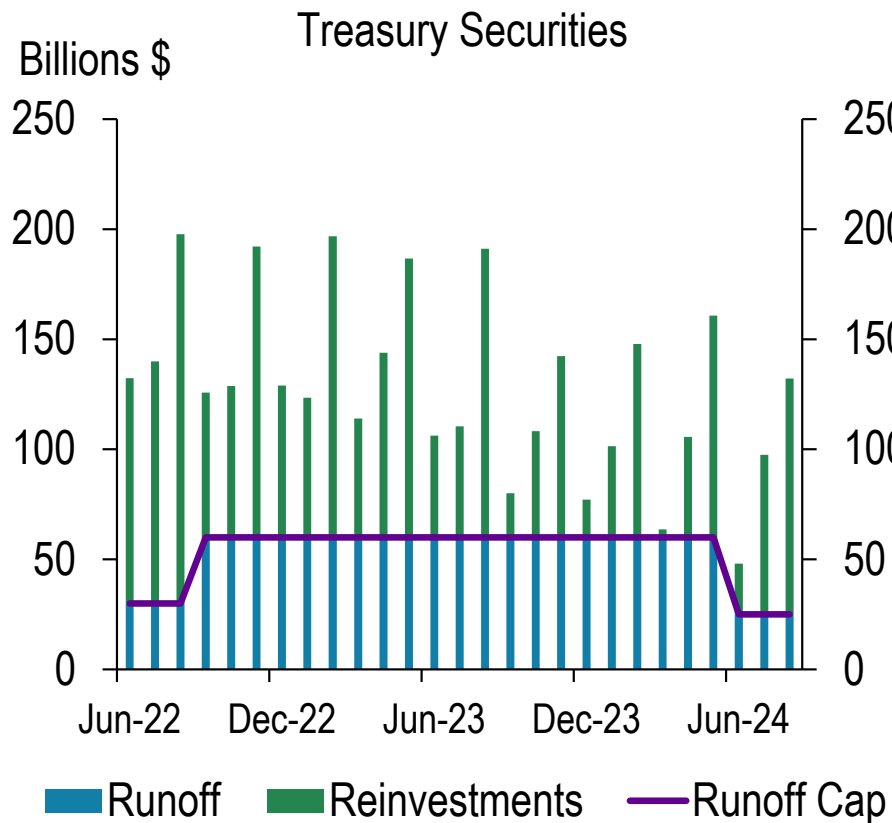
Rate cuts initially failed to pass through to long-term interest rates



After a rapid initial pace of purchases, the prospect for a weak recovery prompted ongoing purchases



While purchases were rapid, runoff has been more gradual



Mechanics of balance sheet reduction: Fed Accounting 101

Shrinking the Fed's balance sheet: Bank Reserve Reductions

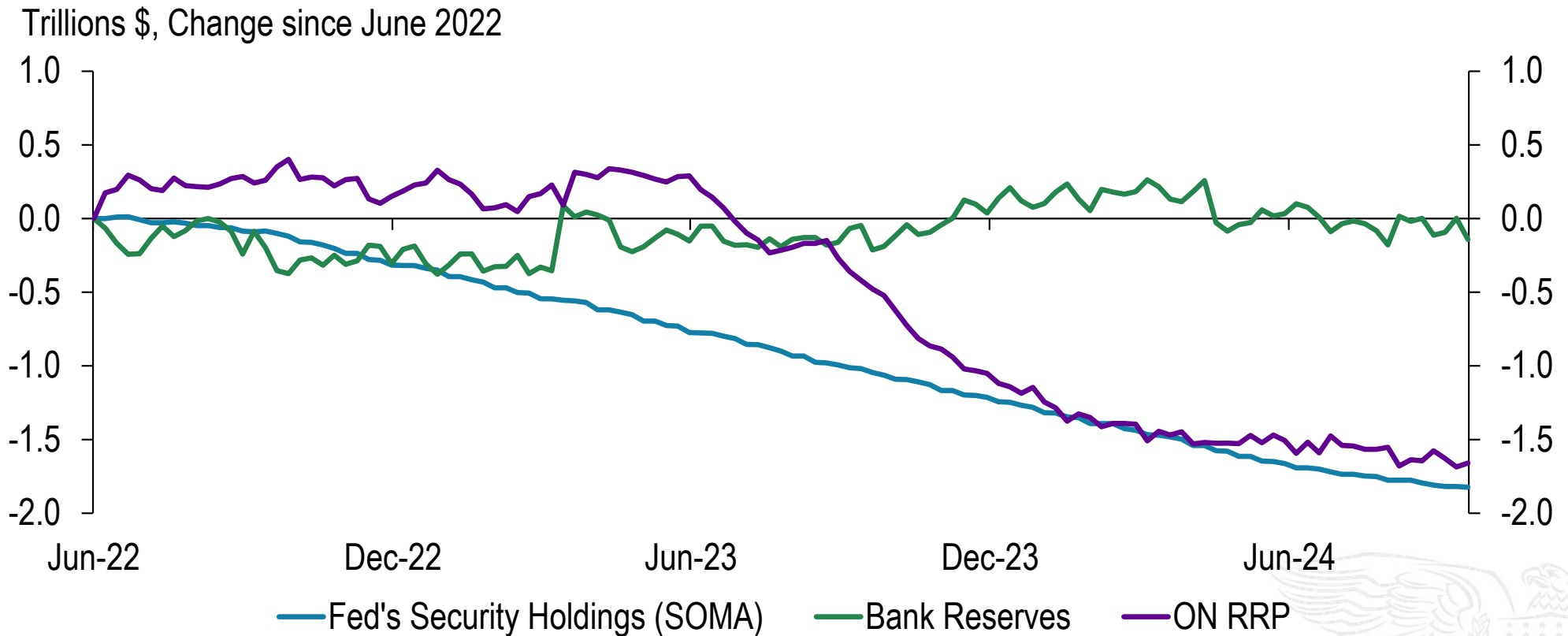
Federal Reserve		Banking Sector	
Assets	Liabilities	Assets	Liabilities
Treasury securities (- \$1)	Reserves held by banks (- \$1)	Treasury securities (+ \$1)	Deposits
	ON RRP Balances	Reserves at the Fed (- \$1)	

Shrinking the Fed's balance sheet: ON RRP Reductions

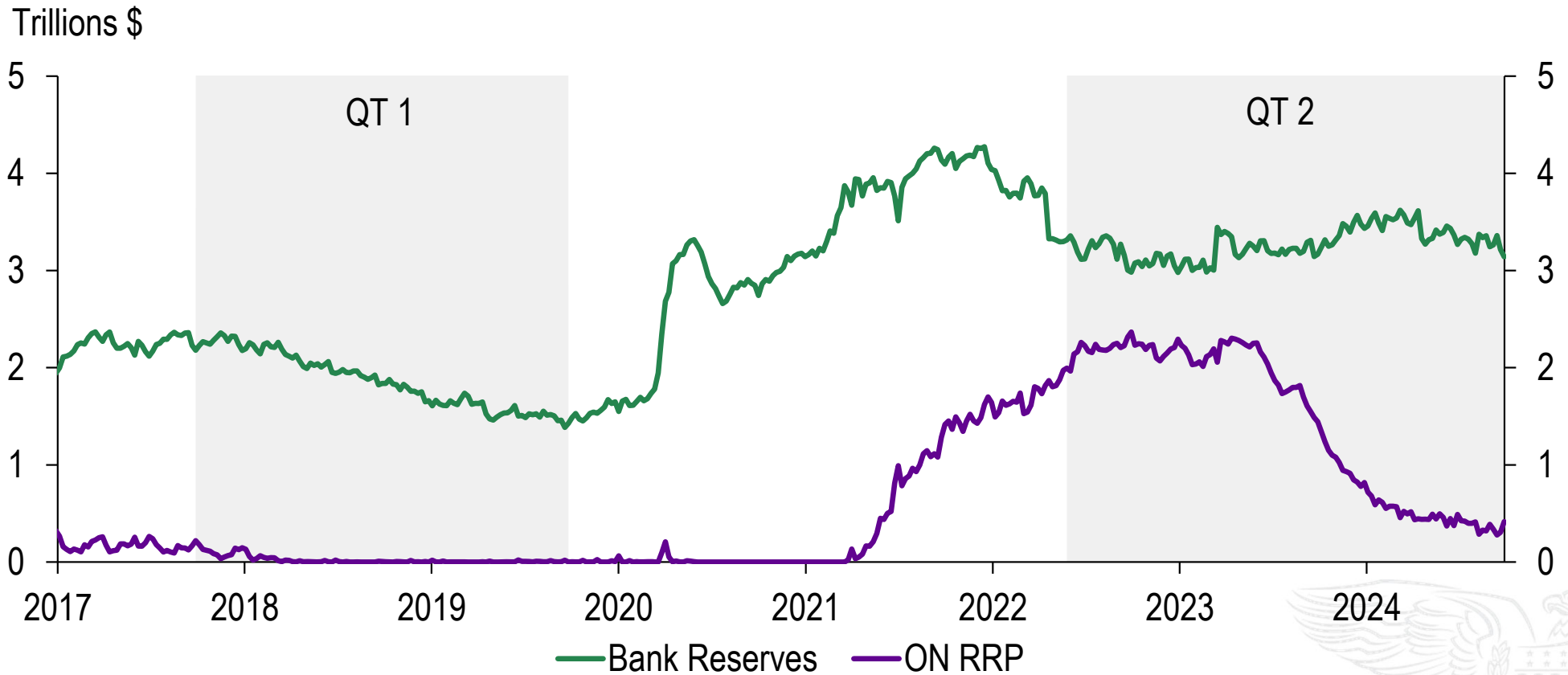
Federal Reserve		Money Market Fund Industry	
Assets	Liabilities	Assets	Liabilities
Treasury securities (- \$1)	Reserves held by banks	Treasury securities (+ \$1)	Shares held by households
	ON RRP Balances (- \$1)	ON RRP Balances at the Fed (- \$1)	



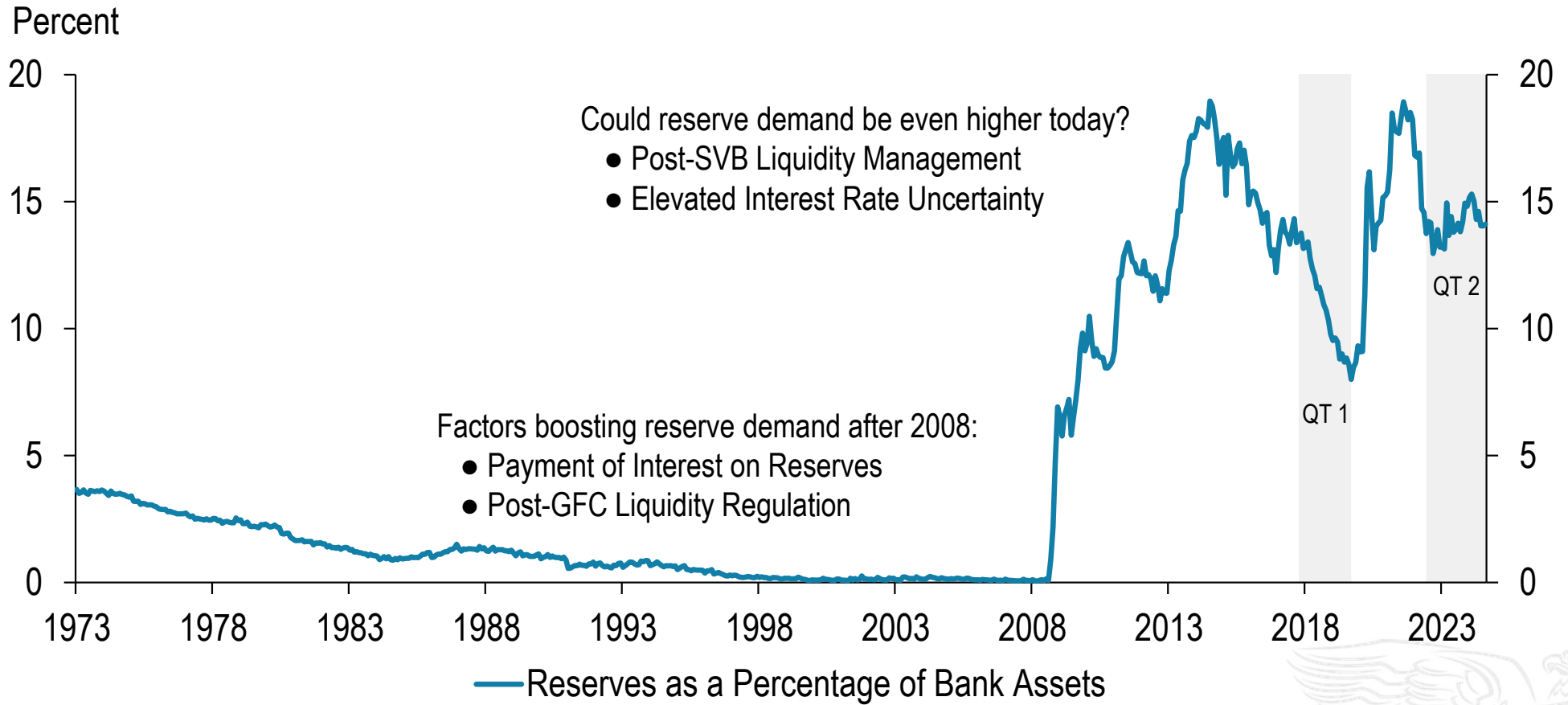
Liability reduction has come almost entirely through ON RRP, bank reserves are largely unchanged



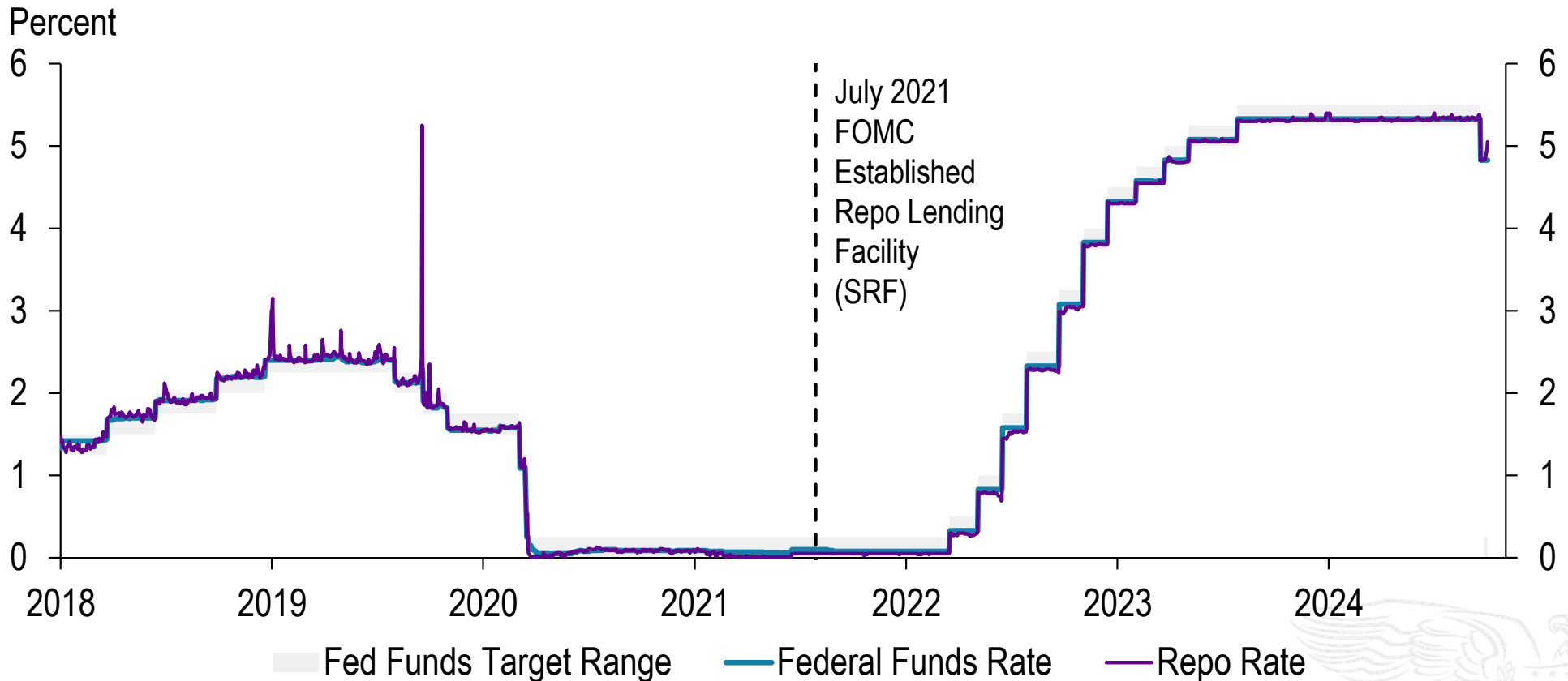
As ON RRP levels decline, further balance sheet reduction will begin to drain bank reserves



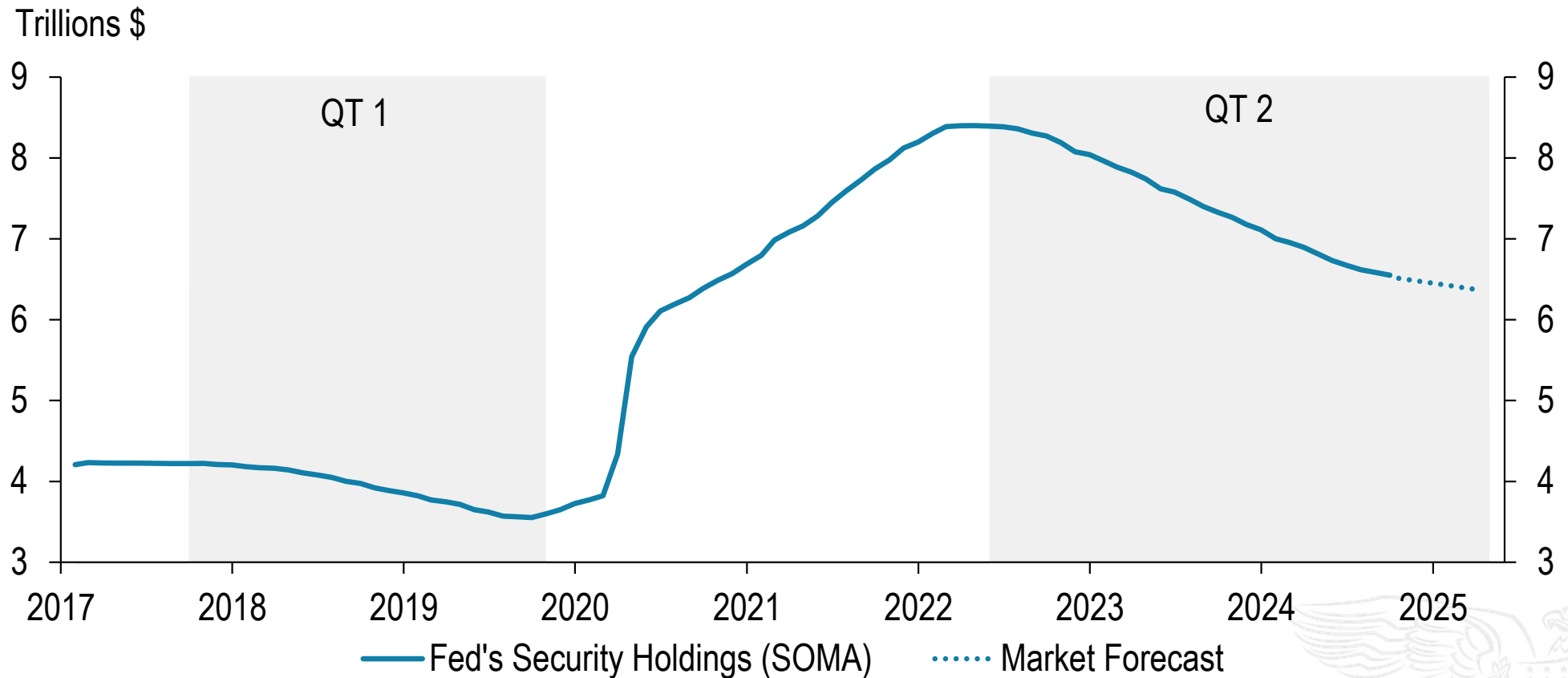
Much uncertainty surrounds the demand for reserves from banks



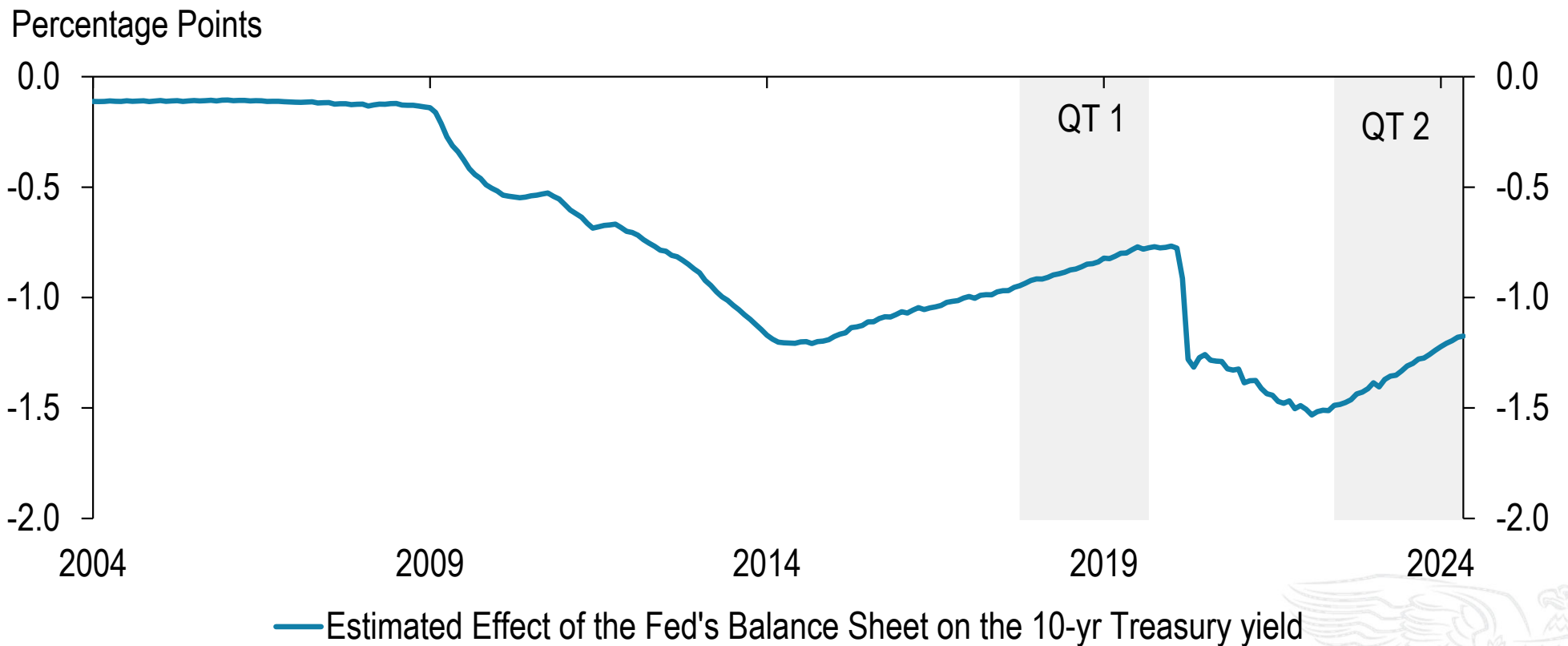
Testing the limits of ample reserves viewed as costly after September 2019 repo spike



Market expectations are for balance sheet runoff to end in early 2025

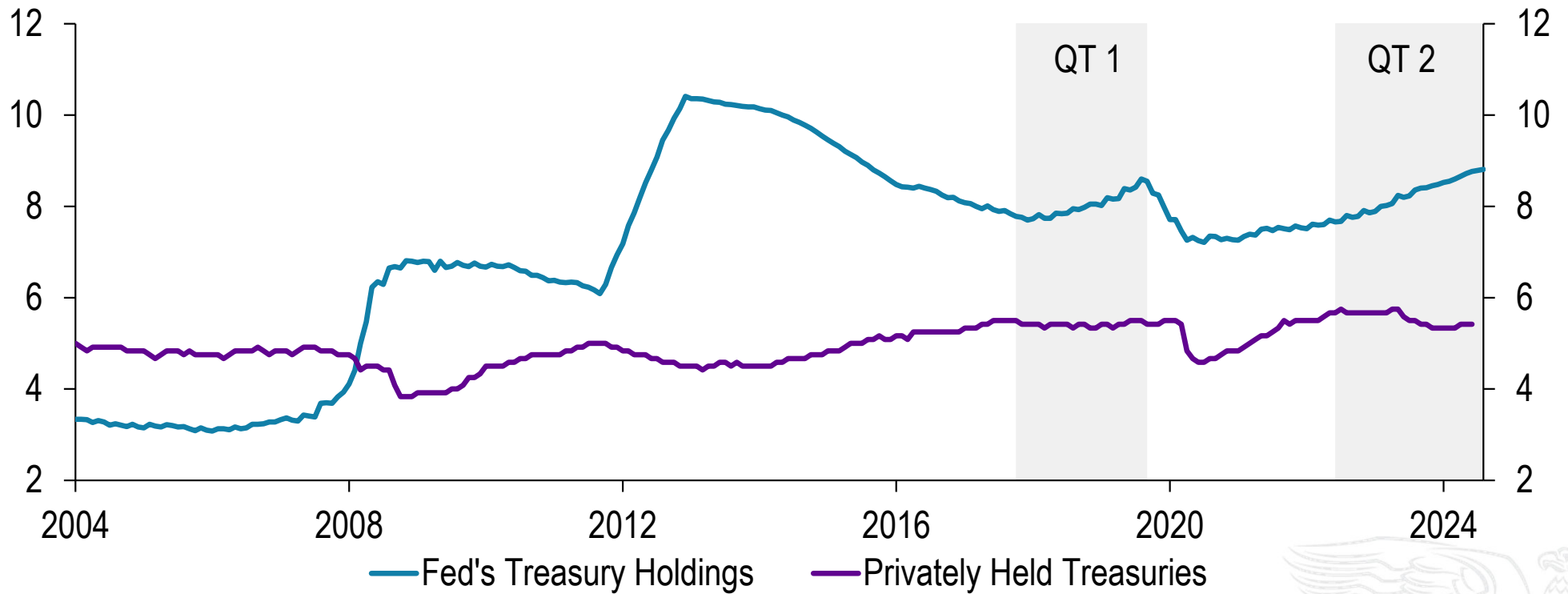


The Fed will maintain a sizeable footprint in financial markets even after runoff ends

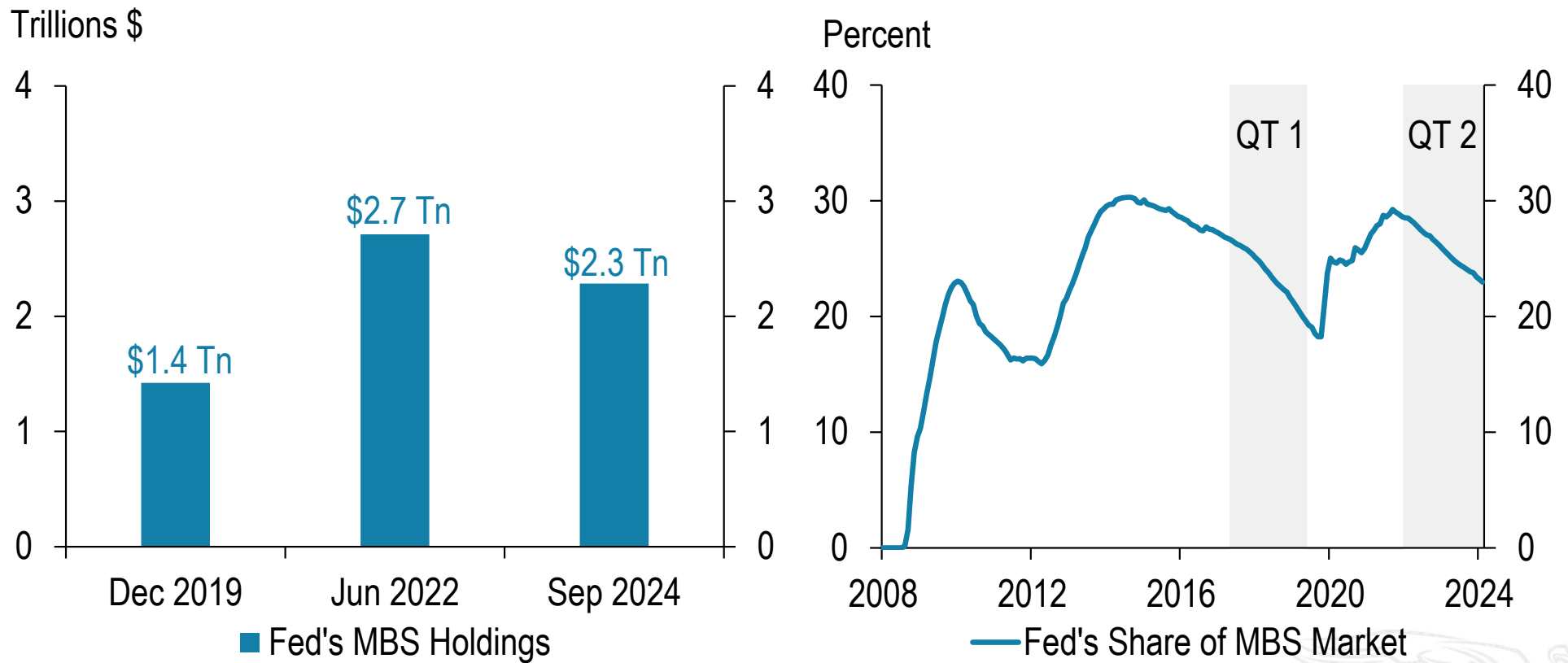


The Fed's Treasury portfolio is weighted towards long-term securities

Weighted average maturity in years



Passively unwinding mortgage holdings will take considerable time



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