Transcript of Lorie Logan on the Macro Musings Podcast

A closer look at monetary policy operations, the Fed's new Standing Repo Facility, and the future of the Fed's balance sheet.

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Lorie K. Logan, Executive Vice President

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David Beckworth: Lorie, welcome to the show.

Lorie Logan: David, thanks for having me. It's a pleasure to be here.

Beckworth: Well, it's a real treat for me, and I know my listeners will also really enjoy having you on the program today. We are recording this January 5th, and as it turns out, Lorie, the minutes from the December FOMC meeting just came out, and I was reading them before I got on the show here with you. And I read a paragraph that was all about you. I'm reading a paragraph that says, "In discussing recently established backstop facilities, the manager noted continued progress." And it goes on to talk about the standard repo facility and the FEMA repo facility. I'm like, "Hey, that's Lorie. I'm going to be speaking to Lorie today."

Beckworth: So, it's a real honor for me, and I know many of my listeners as well, to get you on this show. Because we talk about this stuff a lot, but to get someone who's actually on the front lines, who's actually doing it. Wow. What a real treat for us. So, thank you for coming on the show. Okay. Lorie, maybe you can tell us a little bit about yourself. How did you get to where you are? What is your career journey like? Any lessons learned along the way?

Logan: Well, thanks. And again, David, it's great to be here. I've had a strong interest in public service and public policy from a young age, which I think was inspired by my family's involvement in local politics, growing up in a small town in Kentucky. And then later fostered by experiences studying political science at Davidson College and later at Columbia University's School of International and Public Affairs. And it was at Columbia that I was first introduced to global economic policy issues and opportunities at the Fed. And since then, I spent over 20 years, nearly my entire career, in the Markets Group at the New York Fed, deepening my own understanding of the financial system and working to make monetary policy implementation more effective.

Logan: I started off in 2000 as a trader analyst, reporting on financial market developments and executing domestic operations on the government securities desk. And it was this real-time interaction of analysis and trading that provided an incredible opportunity to learn and to work at the intersection of public policy and financial markets. And I still love those aspects of what I do today. My time in the Markets Group has been marked with periods of accelerated learning. I was on the desk and involved with the historic lending in the securities lending program on September 11th. I crafted plans for liquidity facilities and the large scale asset purchases during the global financial crisis, and led development of the overnight RRP facility to support interest rate control after the GFC. And these experiences deepened my perspective, and over time I grew into increasing leadership positions.

Logan: Two years ago, I was appointed to the SOMA manager role, where I'm now responsible for implementing the FOMCs policy directives and managing the system's $8 trillion securities portfolio. And this involves overseeing open market operations and reporting on financial markets at each of the FOMC meeting minutes. And you heard about that in the minutes that were released today. And working at the Fed has just been an incredible experience. I've had the privilege of serving in a mission-driven organization, one that's focused on making the economy stronger and the financial system more stable for all. And to me, that's especially grounding each day. And I get to do it with an amazing group of people.

Beckworth: Yeah. I want to talk about that group of people in a minute, but just going back to your experience, you were there from 2000 to the present. So, you've seen a lot, as you mentioned. You have a lot of institutional knowledge inside of yourself, a lot of human capital for the New York Fed, and you were there for 9/11. And I'm just wondering, what was it like to go through that? Did you have to shut down the office? Were you there working through it? What was it like at that time? Because you're pretty close to the location of the Twin Towers.

Logan: That was just an incredibly difficult experience, and very early on in my tenure at the New York Fed. We were very close to the towers and it was both a difficult time personally and professionally for me and for all those that I was working with. I was there that day, and it was a difficult day to participate in the operations that we did to support market function, and was difficult in the days after. But at that time, I really learned what it means to be a part of the central bank and the role and responsibility of the central bank to be open and available to provide liquidity when the financial market needs it most.

Beckworth: Yeah. Very harrowing experience for sure. Well, let's talk about your group at the New York Fed. You oversee a lot, and I'm just looking off your bio here. I see four different roles and this may understate what you actually do, but let me list them off and you can correct me if I'm wrong or add to the list. But one of your roles is, and you mentioned this already, but the execution of monetary policy for the FOMC. Number two, provision of fiscal agent services to the US Treasury Department and support of its debt issuance and foreign exchange operations. Three, analysis of global financial market developments. And four, production of the New York Fed's reference rates, including the SOFR. So, you do a lot. And in each of those, I guess bullet points, you have a lot of things you could unpack underneath that. Is that list a comprehensive list or is there more you would add to that?

Day-to-Day Operations at the New York Fed

Logan: Well, those are all the things that we do on the trading desk, which is a part of the Markets Group at the New York Fed. In addition to those activities, the Markets Group also, like each of the reserve banks, executes the discount window and also provides financial services for other or central banks. But as the SOMA manager, I'm responsible for overseeing policy implementation analysis. And to do that, I lead a large team of traders and analysts and policy advisors with a real range of backgrounds in finance, economics and policy. So, maybe I'd to share a little bit about my day-to-day and how that looks, most days, and also how that changes over time.

Logan: In terms of my day-to-day, I think my kids, who've had just a really unique and front row seat as we've been working remotely during the pandemic, describe it best. They say my day starts very early and is jam-packed with meetings. And I think that's pretty accurate. My day does begin early. Often starting on an international call before 7:00 AM, but some staff come in even earlier around 4:00 to begin monitoring overseas markets. And then we all come together each morning at 9:05 to discuss our operations and how we're interpreting markets.

Logan: It's an important meeting for me, and it's a meeting that's been held at that time for decades. At that meeting, I typically have my eye on how effectively our operations are working. And I'm also thinking broadly about markets, trying to put what the team is seeing in the context of the FOMCs goals. And then the rest of my day is typically spent in meetings geared toward helping the group achieve on its mission. We run a big operation to manage the portfolio. There's a lot of deliberation and planning to ensure the operations run smoothly and that we communicate about them clearly. And I also spend a significant amount of time with our board colleagues in DC, and then with policymakers, about bigger picture implementation strategy decisions.

Logan: We also to maintain a broad range of external relationships. And a lot of my time is focused on those relationships, and with other central bank colleagues, to share implementation experiences and to really learn from each other. The most important part of my time though is spent on our people and what they need to be successful. I manage a large team, as I said, and work to ensure that we understand our evolving priorities and that the team's working well. We certainly faced some tough challenges recently, as we've shifted to a remote virtual environment, and that's going to be a continued focus as we develop new ways of doing our work after the pandemic.

Beckworth: Well, let's say there's a crisis emerging, let's say for example, repo panic 2019. You see things unfolding, do you have the power to go ahead and do something, or do you have to call the FOMC first and get authority from them? Are you empowered at some level to respond to market developments?

Logan: As you noted, there are definitely periods when we have to organize our time to be more responsive to these evolving developments. And in those times, the structure of the day is quite similar, but we're in this crisis management mode, and the pace accelerates. The decisions that we're making are more complex and made with less information, but we do make them with an eye to flexibility so we can learn and adapt quickly. And really depends on the environment that we're in at the time, which decisions we make directly on the desk and which we are making at the direction of the FOMC. In each FOMC meeting, the committee issues a directive to the desk, which gives us instructions on how to implement monetary policy, so some of those decisions are ones that we make be at the direction from that particular directive for the intermediate period. And then there's others that might be unusual that we may want to recommend. And those may require a change in the directive or an actual committee vote in between meetings. So it really depends on the environment we're in.

Beckworth: Okay. I want to move on to actual developments and what you have done over the past few years, particularly what happened in March, 2020. Before we do that, go one last question about the New York Fed. And this is a less serious question. But I'm sure you've seen *Die Hard with a Vengeance*, the movie where the Die Hard character ends up at the New York Fed. And these people try to steal gold from the New York Fed. Is the gold still there? Have you visited the gold down in the basement of the New York Fed?

Logan: Well, I'm certain the gold's still there. I haven't actually been in the building in a bit of time, David.

Beckworth: Okay.

Logan: Given the pandemic, but I know it's still there and it is a really interesting tour to do. My middle son actually is the one who's been able to do that tour with me. And it's been a real highlight for him. And hopefully we'll be back in the building and my other kids will get the chance to do the tour, too.

Beckworth: Very nice. All right. So you've given a lot of talks on what happened in March 2020. The "Dash For Cash" as it's called. A number of talks. You were a part of the Fed's response to it. And I was hoping you could summarize for us your view of what happened during that period.

The "Dash for Cash" and Subsequent Policy Response

Logan: So perhaps I'll take a step back and first talk about what we observed at the time. And then turn to how we responded. So in first, in terms of what we observed, we first saw changes in financial markets early in 2020. Equity markets globally were volatile, responding to the virus that was spreading quickly. By late February, as more cases were confirmed in the US, conditions began to decline quite rapidly. I think it's really important to first emphasize the magnitude of the shock that financial markets were absorbing in early 2020. At the time, the economy had been experiencing relatively steady economic growth. And over the course of just a few weeks, market participants became concerned that large parts of the economy could completely shut down, potentially creating a historic recession. And additionally, market participants were also highly concerned that the financial system itself might not function properly in a remote environment.

Logan: The infrastructure of the global financial system is complex. It's interconnected. There are dependencies all over along the chain of the transactions. So while the financial system itself ultimately made that transition relatively smoothly, that was not an outcome, I think, many thought possible at the time. So the result was just extreme volatility as financial assets repriced to reflect these developments. And there was also a broad base dash for cash as investors sought the safety of cash. Even Treasury securities, which are usually seen as the most liquid of financial assets, were being sold broadly to raise dollars. And so this shift was really unprecedented. Unprecedented in its scale and in its scope, and resulted in severe disruptions across financial markets and had the potential to make economic conditions even worse by cutting off the flow of credit to households and businesses that were most vulnerable.

Logan: So how did we respond? Well, over the first few weeks in March, our operations transitioned from business as usual to managing an unprecedented pandemic. By early March, we had already put the staff in a heightened monitoring stance, and had taken steps to increase the size and lengthen the tenor of repo operations. And you'd asked earlier, are there decisions that you can make directly on the desk? And those are two examples of ones that we can make directly. However, the conditions continue to worsen and to broaden. And so, to me, the turning point was March 12th. And it was on that day where we took more aggressive action. First, we offered almost unlimited amounts of funding through the repos. And then later that day, to help alleviate the strains in Treasury cash markets, we announced a shift in our purchases of Treasury bills to purchase across the Treasury coupon curve.

Logan: And that's an example where we actually needed approval from the chair to make that type of decision. So right there, just that one day, you can see the different types of decisions that we make and the authorities that we have. My own sense was that these moves would help stem the dysfunction. But by the end of the day, we were already seeing significant one way flows and conditions continue to worsen. And we could see that in just a broad set of metrics that we were monitoring. So very late that night, we conferenced again with the team to assess whether more aggressive actions were needed, what options we could put on the table, and then whether we could make those options operationally feasible within such a short window of time because we needed to implement whatever recommendation we'd be putting forward that next morning.

Logan: So after a very lengthy call, we decided to recommend that we pull forward an entire month's worth of Treasury purchases into a single day. Such an aggressive option we hoped would signal that we were prepared to take the actions needed to maintain functioning. And so that discussion was really when I realized we were in an unprecedented environment. Just the extraordinary demand for cash was creating conditions that required us to respond with unmatched size and speed. And ultimately, the FOMC announced an unbounded commitment to support market function. And we met daily from that point on about how many and which Treasury and agency mortgage-backed securities to buy. And of course, the Fed also took a broad range of other actions to stem dysfunction across markets, including the FX swap lines with foreign central banks, and also a broad range of liquidity and credit facilities. And it was the combination of these actions, I think, that were successful at supporting the flow of credit in such an uncertain time. And I just want to emphasize that all of this was done by staff working from home.

Logan: Many of them amazing working at home for the first time. And the conditions were quite challenging. And we're always investing in operational readiness, and we'd had virtual capabilities. But we had never operated from home to this extent. So this was a new experience for us and for all of our counterparties. And I'm still in awe of what the team was really able to achieve in those early days.

Beckworth: Yeah. A very amazing story there. And I think it's important for us to do the counterfactual. What if the New York Fed hadn't stepped in? I mean the global dollar funding markets are so large, they're global, as you mentioned. And if you hadn't stepped in, it could have been a really horrible outcome, another financial crisis like we saw in 2008, or worse. And so the demands on your staff, I imagine, just are going to grow over time as global dollar funding markets grow as well. I also want to come back to this, maybe an idea of what was this crisis? And from my perspective, and correct me if I'm wrong, the dash for cash was more of a plumbing issue than a fundamental fiscal solvency issue of the US government. It was just people trying to liquidate positions or get into some of their asset and they couldn't. The plumbing was constrained, maybe even cracked or broken. Is that a fair way to analogize what happened?

Logan: I think the experience really underscored the fact that, while the Treasury market is the deepest and most liquid in the world, there are some underlying fragilities. So I think that's what you're referring to. Of course, the pandemic represented as shock of such magnitude that I think even the most resilient market likely would've experienced disruptions. But we've also seen disruptions to Treasury market functioning in more benign environments. And here I'm thinking back to October, 2014 or September, 2019. And sometimes, with those, there was a seemingly little trigger. So I do think, given the importance of this [Treasury] market, financing the government and in supporting the implementation of monetary policy, that it's critical that we take steps to enhance the plumbing and resiliency of the market. So I do think that is a big focus of the work that we're doing on the desk and the inner agency working group on Treasury markets is really focused on.

Beckworth: Yeah. I read that report preparing for the show. The inner agency working group for market surveillance from, I guess, November last year. And also, there's been the Brookings Task Force on Financial Stability, Group of Thirty. A lot of great pieces coming out explaining what's going on. And a lot of them have common suggestions for improving. And let me just throw them out there and let me know what you think. So one of them is increased central clearing in the Treasury market. Another is a standing repo facility. And we can kind of check that one off, that's already been adopted. And then several others tweak the supplemental leverage ratio and then better data. But let me just start with the first one, then maybe go one by one. Central clearing, do you see an important role for that moving forward?

The Role of Central Clearing Moving Forward

Logan: I do. And maybe just before jumping into those potential changes to improve their resiliency. Maybe I could highlight just a couple of themes from my own experience. And I think that we've seen across studies that you mentioned, because I think it's those vulnerabilities that these different proposals will need to be addressing. And I think that'll help us evaluate them as we talk about it. I really think there are four themes that have resonated with my own experience from the studies that we've seen come out. One common theme is that the US Treasury market has grown so much and it's really outpaced the growth in dealer intermediation capacity. Another change in the Treasury market is the growth of electronic trading and non-dealer intermediaries.

Logan: Some electronic markets have high frequency trading and very limited customer interaction. And as a result, participants are less likely to continue engaging in this market when volatility increases. And the third is the proliferation of trading venues and settlement mechanisms that have also created some fragmentation in the market structure. And I think, and result in more frictions across markets, particularly in times of stress. And we saw this play out in March and in April of 2020. And then finally, even as the market becomes more complex and interconnected, real-time data on positions and flows in the US treasuries is still pretty limited. And that reduces visibility for both market participants and for the official sector. So I think as we look at these different proposals, it's important to keep in mind these vulnerabilities because I think we want to be addressing these directly.

Logan: And as you noted, several have put forward some recommendations and the IAWG in particular has said that they would focus on five. Those are improving resilience of market intermediation, improving data quality, evaluating expanded central clearing, enhancing trading venue transparency and oversight, and then finally assessing effects of fund leverage and liquidity risk management practices. And I think the key point I'd make in listing these work streams is that it's very unlikely that there's a standalone solution. I think these are all complimentary efforts. And I think the goal is to ensure that the US Treasury market is as resilient as possible using the combination of these changes that have been proposed. So some of the ones you noted central clearing, the SLR, the standing repo facility are all complimentary in that regard. But I do think we need to stay focused on a package of changes and not get too focused on any one proposal in particular.

Beckworth: Well, one of those proposals has come through, come to fruition and that's the standing repo facility. I guess it was last year that the FOMC made that one official as well as making the FIMA repo facility permanent. Tell us a little bit about the standing repo facility. I've been a fan of this idea for some time. I've had some people on the show to talk about it, but what do you see it doing moving forward?

The Future of the Standing Repo Facility

Logan: Well, I do think the decision on the standing repo facility and also the FIMA repo facility, which the committee voted on at the same time was a very historic decision with respect to the framework, and one that the committee deliberated on for some time. These facilities were implemented to support effective policy implementation by limiting the potential for pressures in repo or in global dollar funding markets to spill back to the Fed funds market. In recent years, we've observed that pressures in money markets can emerge rapidly and with little warning. And we saw that in September 2019, and again in March 2020. And since pressures in these overnight markets can be difficult to predict and are harder to tamp down once they emerge, I too do think that a key benefit is their ability to help mitigate rate pressures before they develop into these larger disruptions.

Logan: And this should enhance market confidence and help to limit those pressures from building, even if the facilities end up being little used. So while not the primary objective of the facilities, I think having these backstops in financing markets can also have important positive effects for the treasury market functioning more generally. Certainly, the SRF reduces the potential for disruptions in Treasury repo markets to then hinder the dealer's ability to make markets in the Treasury cash market. And the FIMA repo facility can help reduce sales of Treasury securities by the FIMA accounts by providing them with this temporary liquidity against their holdings.

Logan: Now, of course, these repo facilities alone won't prevent all types of pressures on the Treasury market to the extent that limits on intermediation capacity or sales of Treasury securities are happening for factors other than the need for temporary liquidity. Repo won't fully substitute for outright sales of securities, but they can meaningfully I think limit the potential for disruptions. It is a very important development, not only for our monetary policy implementation framework, but also for the Treasury market resiliency efforts that we're working on.

Beckworth: Yeah, it was interesting to read today in the FOMC minutes from the December 2021 meeting that several participants said, hey, this standing repo facility will make tapering easier. It may even affect the final destination, the final size of the balance sheet if people can easily substitute between treasuries and reserves. If they know that's there, that confidence will make the transition to whatever your final target may be an easier path. So interesting to see that happen. And again, great timing for the minutes to come out as we are recording this show. And that's a nice segue to the next thing I want to talk about, and that's the Fed's balance sheet. You mentioned already, it's 8 trillion plus, and the FOMC has announced… or it is already tapering. And I know you can't speak to policy, but I'll just say from my side, it appears from the minutes today that there's going to be some QT or actual runoff occurring this year. And I'm just curious from your perspective, how does that work? How would we see your office, the Federal Reserve in general, do balance sheet reduction?

Asset Purchases and the Process of Balance Sheet Reduction

Logan: Well, maybe it's useful just to take a step back and talk about the asset purchases themselves as a standard tool in the Fed’s tool kit and how those work mechanically, and then come back to mechanically how they work as we begin to slow that process and ultimately decrease the size of the balance sheet. As I said, the asset purchases have become a standard tool in the toolkit to provide accommodation when short term interest rates are near zero. And in terms of the mechanics, I think about them working in a couple of ways. First, they work through the portfolio balance channel. When the Fed or the desk purchases securities from our counterparties, it raises the price of these securities and then lowers their yields. And those counterparties who sold securities to us may then rebalance their own portfolios to invest in other assets, lowering yields broadly, and then easing financial conditions.

Logan: So that's the first channel we tend to think about these working. And the second one is a signaling channel. Asset purchases can signal that the Fed's committed to maintaining accommodated conditions and is unlikely to thereby raise the Fed funds rate for some length of time, and this also reduces yields by lowering the expected path of policy rates. And in periods of stress, such as that we saw in the pandemic, asset purchases can also restore market functioning and reduce risk premia that could otherwise increase yields. And this was a key benefit of the purchases early in the pandemic. So the overall goal again is to lower long term interest rates and keep credit flowing to the economy. And since the onset of the pandemic, the desk has been directed by the committee to purchase significant amounts of treasuries and agency MBS.

Logan: And our assessment is that they've been very effective at easing financial conditions and generally supporting the recovery. And as you noted at the December meeting, the committee decided to accelerate the taper of these asset purchases. And this action was prompted by a rapidly strengthening labor market and currently elevated inflationary pressures and Chair Powell noted that a quicker conclusion of asset purchases would better position policy to address the full range of plausible economic outcomes. So our focus on the desk is on executing this reduction in the pace of asset purchases and to do so smoothly for the FOMC. And so far, I think this has gone well, and we haven't observed any challenges associated with the decline and purchase amounts. But of course, whereas I said always monitoring developments and keeping an eye towards effects there.

Logan: Now, at some point when the current level of accommodation is no longer necessary to achieve the committee's goals, the committee's going to want to reduce the size of the Fed's balance sheet and unwinding these measures demonstrates that this important tool is used when needed. But importantly, it can be withdrawn once the committee's goals are achieved. And we do have some experience with the mechanics of reducing the balance sheet. At the conclusion of the large scale asset purchase programs after the global financial crisis, the committee did undertake balance sheet normalization that lasted about two years. So in terms of the mechanics of that process, balance sheet normalization was conducted in a gradual manner and a predictable manner. I think those are the two key themes there. And there were two implementation elements to that. First, principle payments from our maturing securities were no longer reinvested and that reduces the balance sheet size. And in other words, it was an organic process. We didn't sell assets. And then the second mechanical feature was that caps were set on these monthly redemption amounts to ensure a steady decline.

Logan: And I think overall this process, that process of natural maturities rather than sales and caps to ensure a steady pace seemed to work quite well. And at the December meeting, the committee did review this previous experience that it had with balance sheet normalization. And there were several aspects of that previous approach that the committee felt remained applicable. Maybe I'll just highlight a couple of those themes from the discussion and these were highlighted in the minutes. The first one I think is clear communications, you know, clear communications provided in advance of the policy decisions were viewed as helpful in setting expectations and enhancing understanding of the overall policy approach and the second was consistent with the previous normalization episode. Changes in the target range for the Fed funds rate were still seen to be the primary means of adjusting the stance of policy.

Logan: Then third, using caps on these redemption amounts, the mechanical process I talked about, can ensure balance sheet reduction occurs in a measured and predictable manner. I think that was recognized as being a very useful approach. Then fourth, retaining flexibility to make adjustments to the approach was viewed as helpful in nimbly responding to economic and market conditions. Those were some of the common themes, I think, that were recognized in looking back at the previous experience. But there were also some differences, and the committee noted that the economic outlook is much stronger now than in the previous episode and that the balance sheet is much larger and that these differences would be taken to account when making decisions about the balance sheet. As the minutes and the chair noted, no decisions have been made. The FOMC is going to be discussing these balance sheet issues in coming meetings, and our focus on the desk will be working to support those deliberations.

Beckworth: Yeah. You've had the experience already of doing QT, or quantitative tightening, but still, this is not a trivial task, right? I mean, there's a lot of things you got to consider, as you mentioned. You got to do only so much or you allow the principal to run off. You got to control that. You got to gauge the stance of the economy. That's the conditional forecast. You got to worry about the TGA balance, right? What's the Treasury doing? You have all these moving parts that you have to control for. So you do have your work cut out for you when it comes to actually implementing this. It's not just press a button on a keyboard, and then it's done. There's a lot of judgment, I guess, involved in this exercise.

Logan: Well, I think there are a whole host of considerations that you outlined that the committee will be thinking about and exploring in the upcoming meetings. At some point, the desk will get a very clear directive from the committee about how to implement this policy normalization and balance sheet normalization process. That directive, I think, will be very transparent and clear in terms of the mechanics of what we'll need to do to deliver on that directive.

Beckworth: Now, don't you have some blog posts coming out at the New York Fed related to this discussion of the Fed's balance sheet?

Logan: We do. Next week, we'll be releasing a series of blog posts about the Federal Reserve's monetary policy implementation framework. The purpose of the series is to help talk about how the Federal Reserve implements policy today. We'll be looking at the implementation framework, the tools, interest on reserve balances in the overnight RRP facility in supporting that framework. We're going to talk a little bit about technical adjustments to interest on reserve balances and overnight RRP and how we've used technical adjustments to support policy implementation. Then a little bit more about this new backstop facility, the standing repo facility that we talked about earlier. So I'm excited about the series and hope the audience takes the opportunity to review them.

Beckworth: We look forward to seeing it. So speaking of the Fed's balance sheet, there's this runoff that's likely to occur. The balance sheet will get smaller. There's some destination. Is it too soon to start thinking about where that destination is? Is that going to be determined by the FOMC? Let me rephrase the question this way. Will the FOMC come up with a dollar size for the Fed's balance sheet, or more general, we'll know we're there when we're there kind of framing for that journey?

Is There an End Goal for the Fed's Balance Sheet?

Logan: Well, in terms of the future of the balance sheet, the committee has stated that it plans to continue to implement policy in an ample reserves regime or a floor system. So we'll talk more about that in the post that'll be released. This implies that the balance sheet will need to be maintained at a level that supplies ample reserves to the banking system. Reserves right now are very large. They're highly abundant or super abundant, so I expect the balance sheet could decline some way from here and still maintain an ample level of reserves. But I think the key point is that the long run size of the balance sheet is uncertain because banks' demand for reserves varies over time.

Logan: At the December FOMC meeting, participants suggested that it will be important that we monitor money market conditions as reserves fall in order to assess the appropriate level of reserves to maintain ample conditions. Indeed, we do have a lot of money market data, which allows us to observe those conditions in money markets at a granular level. And we do have our experience from the prior normalization to help serve as a guide when assessing those reserve conditions. And we have the new standing repo facility in place as a backstop now, which wasn't the case during the prior normalization period. So I expect that the long run portfolio size will again be driven by demand for Federal Reserve liabilities consistent with maintaining an ample reserves regime. The exact level is something that's unknown and will be something that we'll be monitoring to determine as the balance sheet declines.

Beckworth: Well, I'm looking forward to this journey, and I'm especially looking forward to the role that the standing repo facility will play in this journey. Because as you said, it could affect how many reserves are demanded by the banks. In the few minutes we have left, Lorie, I want to ask about the framework you mentioned, ample reserves framework, or a floor operating system. We haven't touched on this. The overnight reverse repo facility, does that set the floor effectively for the rates and you could think of standing repo and discount rate being the ceiling, and you want the Fed funds rate somewhere between that? What role would the interest on reserves play in that system?

The Floor System and the Role of Interest on Reserves

Logan: Well, just going back to 2019 when the FOMC adopted this framework for implementing policy, where they supply an ample supply of reserves that ensures the Fed's administered rates influence the Fed funds rate and other overnight rates. In a floor system, our job is to ensure that reserves are supplied to meet banks' needs for liquid balances and that the IORB and the overnight RRP are important features.

Logan: Now in most economies, the interest on reserve balances would be enough to control interest rates. However in the US, banks are a smaller share of the financial system. So when the FOMC pursues policies such as asset purchases or lending like we've been doing since March 2020, expands the Fed's balance sheet, and banks can end up with more reserves than they're comfortable holding. So during these times, they lower the rates at which they take deposits, and the rates trade below IORB. So in order to enhance rate control, the overnight reverse repo facility was established, and this does place a floor under overnight rates by providing a range of money market participants, this other option.

Logan: This really does two things. It improves investors' bargaining power in overnight markets, and it creates an alternative investment that can spread Federal Reserve liabilities beyond reserves that reduces the pressure on banks' balance sheets. The FOMC's been essentially operating with this floor system for many years now and using both IORB and the overnight RRP as key tools. That's turned out to be quite effective at controlling rates through a variety of environments.

Logan: Recently, the overnight RRP has become a more important component of that framework, along with the growth in the Fed's balance sheet. Overnight RRP usage tends to grow when there are downward pressures on rates relative to IORB. This can happen when reserves are elevated and banks try to shed deposits or when the supply of short-term investments such as Treasury bills declines. In the current environment, we're seeing both of those elements. So the overnight RRP facility is particularly important now and a particularly attractive investment for money market participants. So we've seen the facility increase to record high levels. I think my main observation would just be that both IORB and overnight RRP are important components to the floor.

Beckworth: Well with that, our time is up. Our guest today's been Lorie Logan. Lorie, thank you so much for coming on the show.

Logan: David, thanks for having me. It's been a real pleasure and hope to be able to return some time soon.

Beckworth: Okay. Thank you. Thank you so much.