Congressional Budget Office
Nonpartisan Analysis for the U.S. Congress

Recent Changes to CBO's Projections of Remittances From the Federal Reserve

February 2023

Decreases in CBO's Projections of Remittances Driven by Increases in Short-Term Interest Rates

In its February 2023 baseline update, the Congressional Budget Office significantly reduced its May 2022 estimate of remittances from the Federal Reserve—by $29 billion (or 97 percent) for 2023 and by $99 billion (or 16 percent) for the 2023–2032 period. Those changes are largely explained by higher short-term interest rates in 2023 and 2024, which increase the Federal Reserve's interest expenses.

CBO now estimates that the Federal Reserve System will have costs that exceed its income through 2024, reducing remittances to close to zero for several years. In CBO's projections, remittances nonetheless continue in every fiscal year in the projection period, reflecting the probability that some Federal Reserve banks will continue to make profits and remit them to the Treasury.

This slide deck provides additional information about CBO's projections of the Federal Reserve's activities, as well as the effects of those activities on its net profits and the resulting projections of remittances. These slides also include CBO's updated projections of the assets and liabilities of the Federal Reserve.

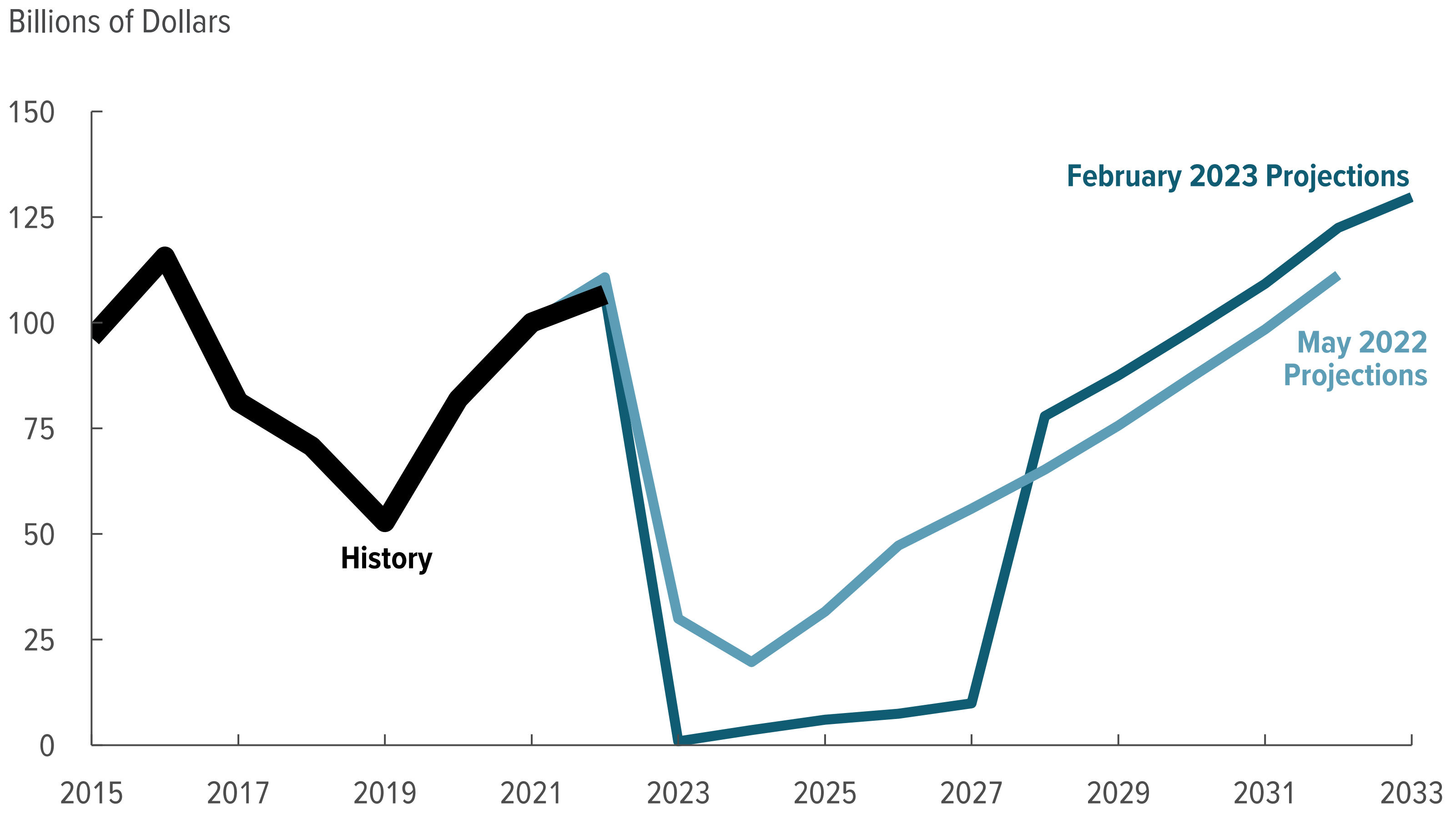
The Federal Reserve’s Profits

Federal Reserve banks earn income from interest-bearing assets, primarily Treasury securities and mortgage-backed securities that were initially purchased through open-market operations (that is, through transactions between the Federal Reserve and the private sector).

Generating interest income is not a specific policy objective of the Federal Reserve but a by-product of its conduct of monetary policy, which is intended to achieve its dual mandate of price stability and maximum employment.

By law, Federal Reserve banks transmit interest income—minus the cost of generating it (which includes paying interest on the Federal Reserve’s liabilities, operating the system, and paying dividends to member banks)—to the Treasury as remittances.

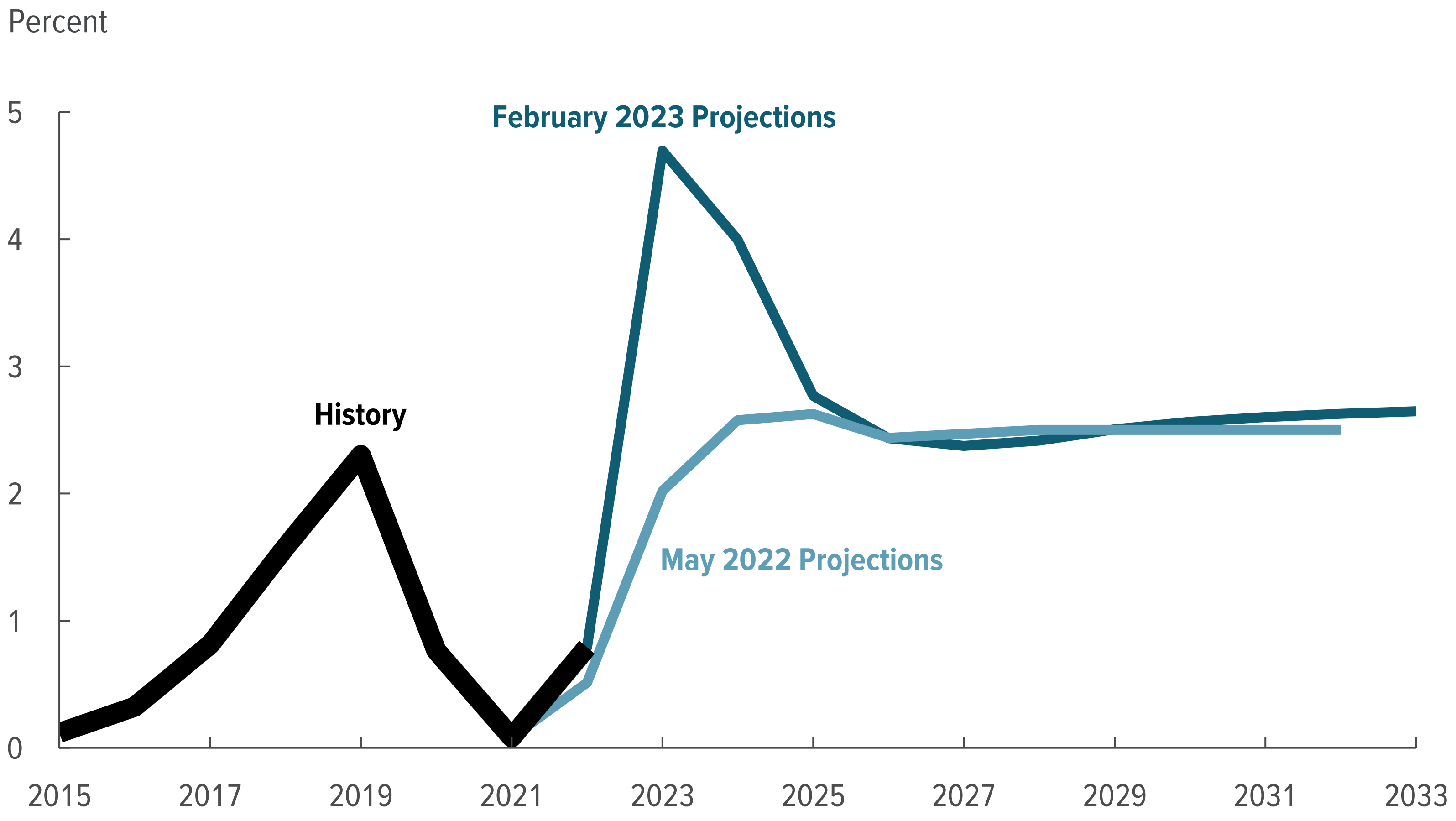
Changes to CBO's Projections of Remittances



The Federal Reserve's monetary policy actions in response to the coronavirus pandemic led to a period of elevated remittances. In recent months, remittances have dropped sharply as monetary policy has tightened.

Those changes have been larger than CBO projected in May 2022, and tighter monetary policy conditions are expected to continue into 2024. In CBO's estimates, the changes all but eliminate remittances over the next few years.

Changes to CBO's Projections of Short-Term Interest Rates

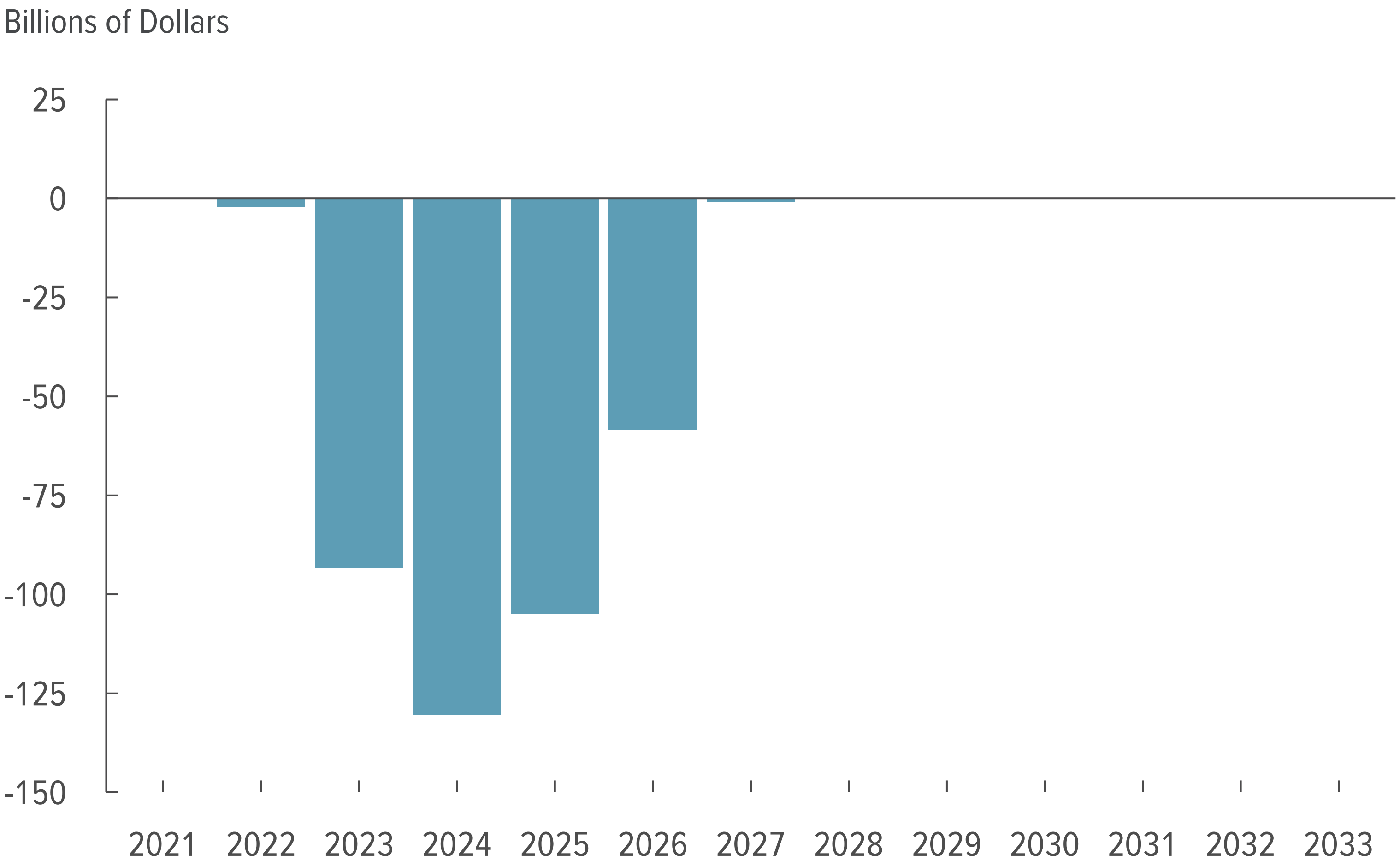


CBO significantly increased its projections of short-term interest rates for 2023 and 2024.

The Federal Reserve uses changes to the rate of interest it pays on bank reserves to manage its primary monetary policy tool, the federal funds rate (the rate that financial institutions charge each other for overnight loans of their monetary reserves).

Those higher interest rates, which increase the Federal Reserve's interest expenses, largely explain the reduction in CBO's baseline projections of remittances.

Continuation of Deferred Assets Until 2028



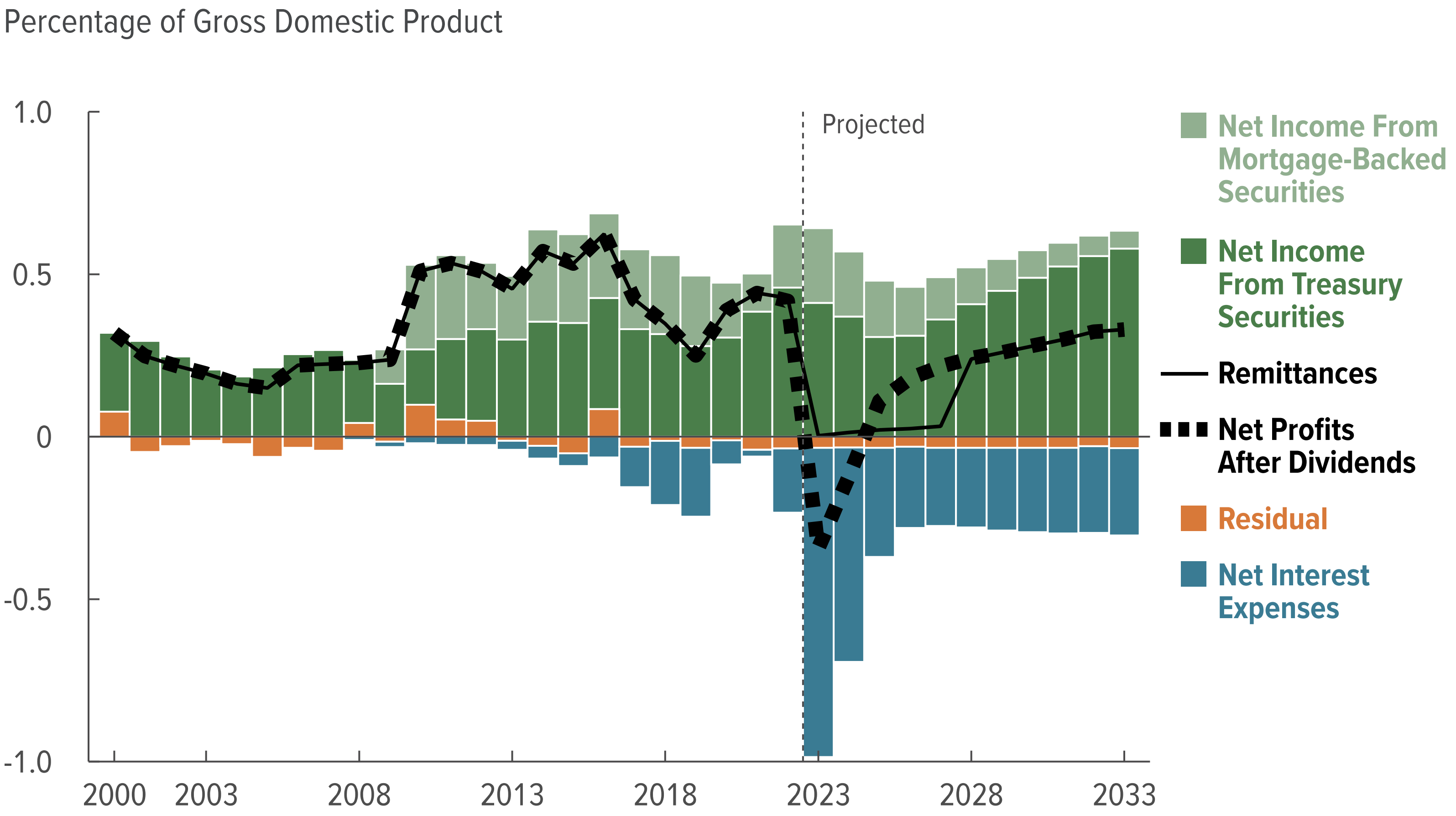
Higher short-term interest rates have raised interest expenses above income in the Federal Reserve System, resulting in a sharp drop in remittances.

When a Federal Reserve bank's expenses exceed its income, it records the difference as a deferred asset (or negative liability) and suspends remittances to the Treasury. As the bank returns to profitability, it reduces its deferred assets until they are paid down and then resumes remittances.

In CBO's estimates, the system as a whole carries deferred assets until 2028, but some remittances continue in every fiscal year of the projection period, reflecting the probability that individual banks will continue to experience net profits and remit them to the Treasury.

Values shown are for the end of the fiscal year.

Remittances Nearly Eliminated by Interest Expenses Through 2024



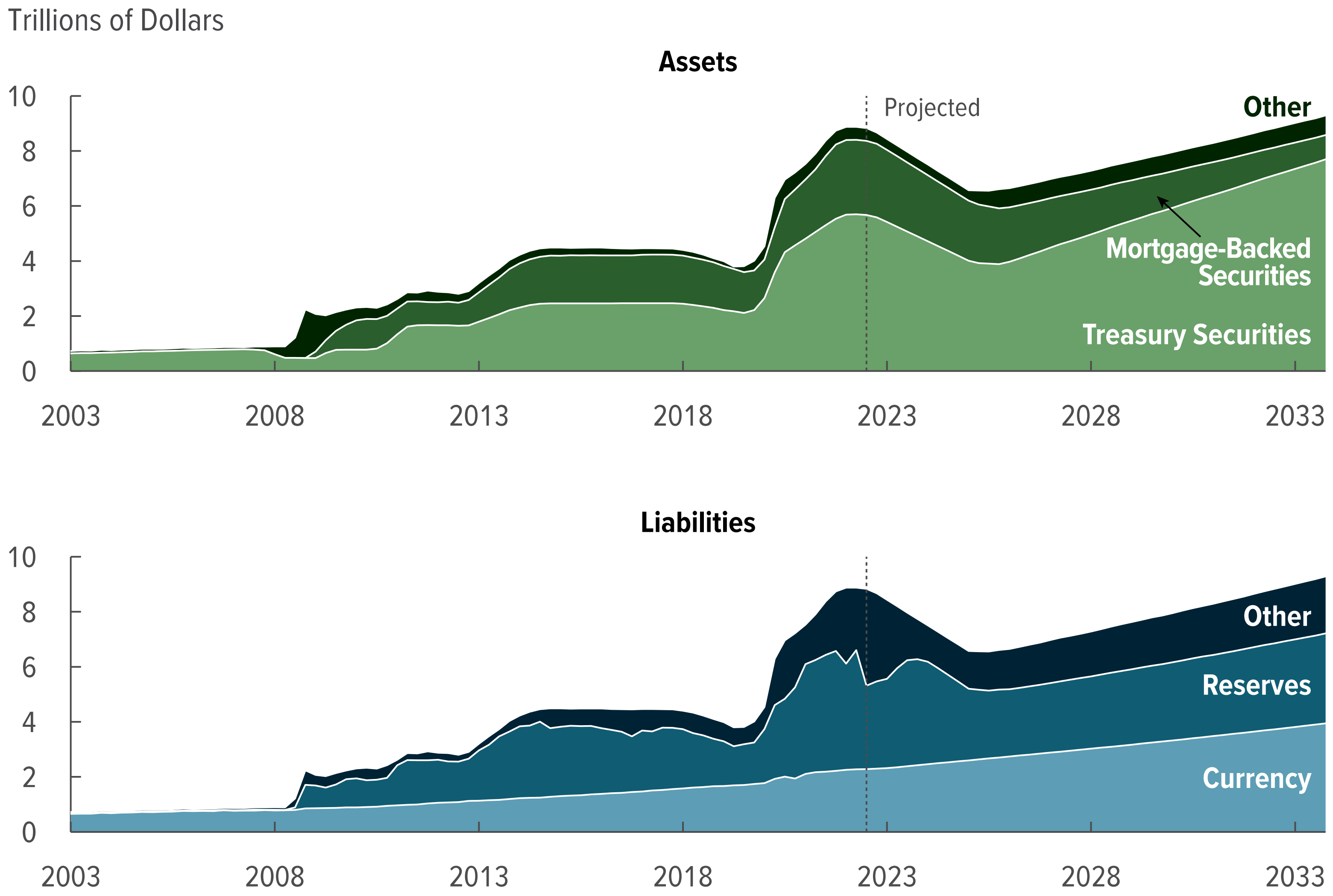
CBO estimates that the Federal Reserve System's expenses will exceed its income through 2024.

As falling inflation allows the Federal Reserve to reduce interest rates, the system as a whole returns to net profitability in 2025, CBO estimates.

Those profits reduce deferred assets in CBO's forecast through 2027, after which the deferred assets have been paid down. Remittances then return to between 0.2 percent and 0.3 percent of gross domestic product, equal to the average over the 25-year period preceding the 2008 financial crisis.

The residual category includes all income and expenses not otherwise shown and small timing effects. (There is a short period between when remittances are determined by the Federal Reserve and when they are recorded by the Treasury.) In the projection period, the residual is primarily composed of the operation costs of the Federal Reserve System.

Composition of Federal Reserve Assets and Liabilities



CBO projects that the Federal Reserve's assets will continue to shrink through 2025.

The Federal Reserve's liabilities consist primarily of currency (or Federal Reserve notes) and bank reserves.

In CBO's estimates, the Federal Reserve's liabilities rise after 2025 as the central bank resumes purchasing Treasury securities to offset the growth in currency and maintain a functional level of reserves.

Uncertainty

The projection of remittances is consistent with CBO’s economic forecast and the assumptions that current laws governing revenues and spending will generally stay the same and that discretionary funding provided in appropriation acts in future years will match current funding, with adjustments for inflation. Changes in fiscal or monetary policies could lead to significant differences in projected remittances.

CBO’s estimates of remittances are subject to considerable uncertainty stemming from the economic forecast, particularly about the path of short-term interest rates in the projection period. Other sources of uncertainty include the interest rates on Treasury securities, as well as the rate of growth in the demand for currency.

Additional Resources

Congressional Budget Office, *The Budget and Economic Outlook: 2023 to 2033* (February 2023), www.cbo.gov/publication/58848.

Congressional Budget Office, *How the Federal Reserve's Quantitative Easing Affects the Federal Budget* (September 2022), www.cbo.gov/publication/57519.

About This Document

This document was prepared to enhance the transparency of the work of the Congressional Budget Office and to encourage external review of that work. In keeping with CBO’s mandate to provide objective, impartial analysis, the document makes no recommendations.

Nathaniel Frentz prepared the document with guidance from John McClelland and Joseph Rosenberg. Julie Topoleski provided comments, and Tess Prendergast fact-checked the document.

Mark Doms, Jeffrey Kling, and Robert Sunshine reviewed the document. Rebecca Lanning edited it, and Casey Labrack created the graphics. The document is available at www.cbo.gov/publication/58913.

CBO seeks feedback to make its work as useful as possible. Please send comments to communications@cbo.gov.