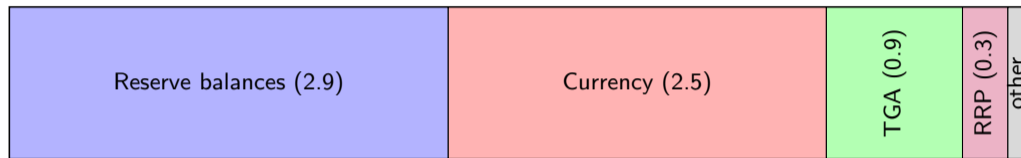


# How could the Fed get a smaller balance sheet?

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## Liabilities of the Federal Reserve System



**Figure:** Liabilities of the Federal Reserve System in trillions of dollars, to scale, as of April 30, 2026. TGA refers to the Treasury General Account. RRP refers to the sum of the Foreign Official Reverse Repurchase pool (\$322 billion) and the Overnight Reverse Repurchase Facility (\$0.8 billion). Data: [Federal Reserve Board, H.4.1](#).

## How could the Fed get smaller?

If the Fed were to aim for a smaller balance sheet with ample reserves, some policies for it to consider, in increasing order of likely difficulty and impact, are:

1. Offset shocks to the supply of reserve balances with open market operations.
2. Add encouragement to banks to get liquidity from the Fed when they run short.
3. Add a liquidity savings mechanism to Fedwire.
4. Tier the interest rate paid to banks on their reserves.

## The largest banks have almost stopped daylight overdrafts

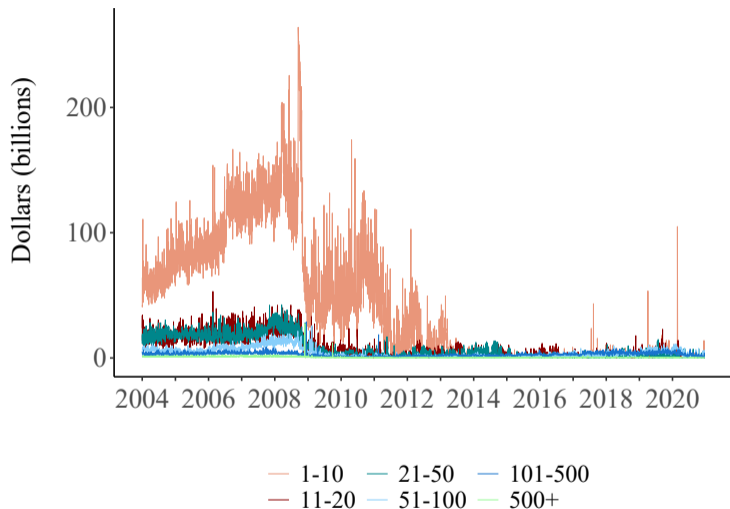
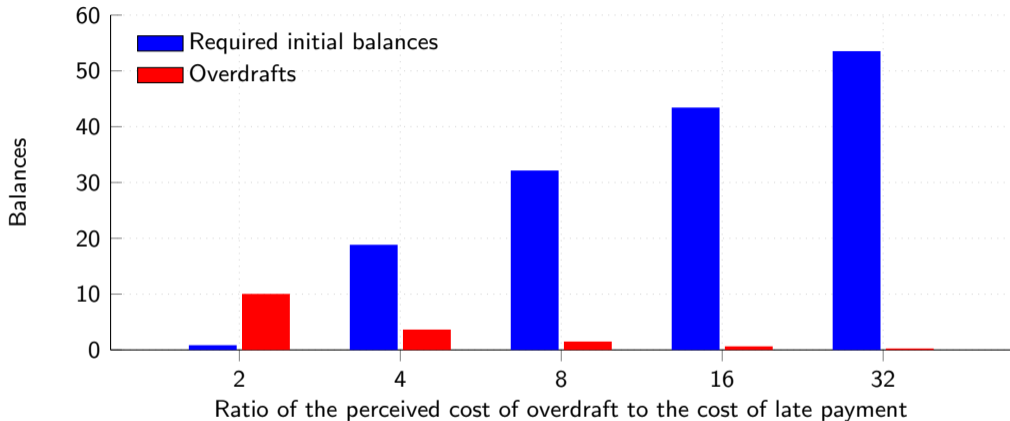


Figure: Overdrafts, banks ranked size. Source: Badev et al (2021), Federal Reserve Board.

## Overdrafting significantly reduces the demand for reserves



**Figure:** To achieve an expected fraction of 50% of early payments, the vertical axis shows required mean initial balances per bank (blue) and the mean chosen quantity of overdrafts per bank (red). Illustrative: based on the equilibrium payment timing model of Yang (2021).

## Liquidity savings mechanisms reduce the need for reserves

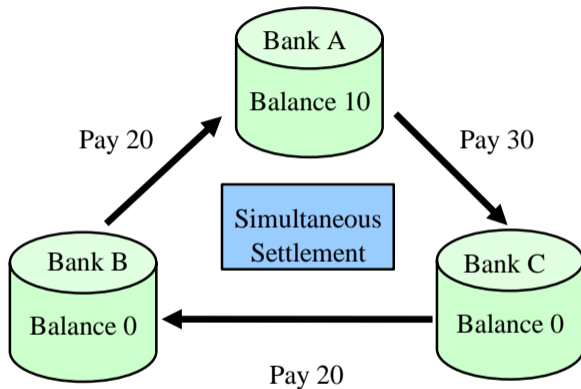
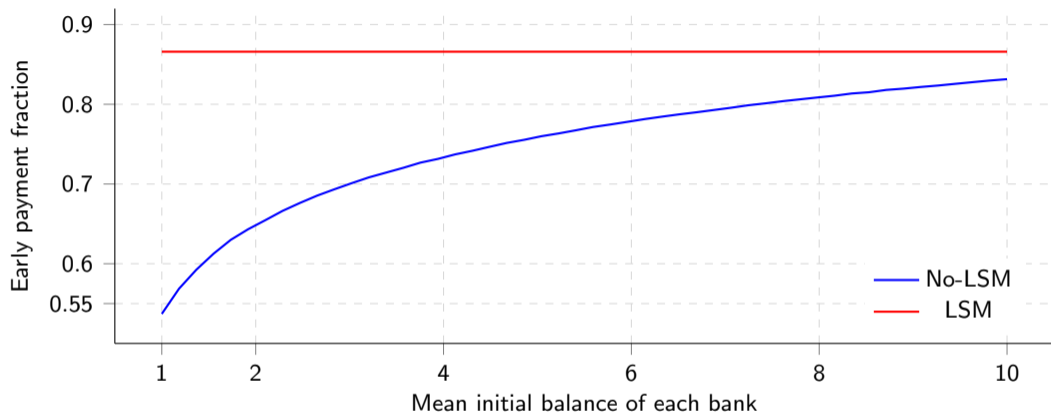


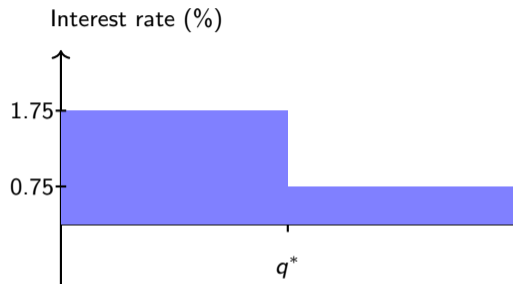
Figure: Multilaterally offsetting payments in the Bank of Japan's LSM, BOJNet. Figure source: Bank of Japan.

## Theoretical impact of an LSM on the promptness of payments

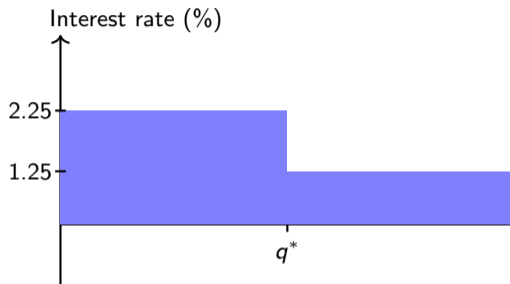


**Figure:** The mean fraction of early payments depends on the mean opening balances of each bank, with and without an LSM. The perceived proportional cost of overdrafts is assumed to be twice that for late payments. Source: Duffie, Sing, and Wang (2026).

## Tiered remuneration significantly reduces the demand for reserves



(a) **The Reserve Bank of New Zealand** remunerates below an assigned quota at the policy rate (e.g., 1.75% in [December 2017](#)) and above the quota at a lower level, typically the policy rate less 1%.



(b) **The Norwegian Central Bank** remunerates reserves below the quota at the policy rate (for example, 2.25% in [October 2022](#)) and above the quota at the reserve rate (for example, 1.25% in [October 2022](#)).