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Lessons Learned: Brian Sack

Sandra Ward

Yale Program on Financial Stability Lessons Learned

Brian Sack

By Sandra Ward

Charged with overseeing the implementation of the asset-purchase programs and liquidity facilities in his roles as executive vice president of the Markets Group and manager of the System Open Market Account at the Federal Reserve Bank of New York (FRBNY), Brian Sack played a critical role in keeping markets functioning during the years 2009–2012. He served as an adviser to top policymakers, and, in addition to implementing the various programs designed to stabilize financial conditions, he monitored their impact and measured their performance. This Lessons Learned summary is based on an interview with Sack on November 13, 2020; the full transcript may be accessed here.

Crisis may require new tools that must be tweaked and honed.

By the time Sack joined the FRBNY in March 2009, the decision to employ large-scale asset-purchase programs (which would come to be known as quantitative easing) had been made and the size of the programs expanded. This was a new tool to help the Federal Reserve affect certain outcomes in the economy that were beyond the scope of the fed funds rate it typically relied on. The implementation of the programs was hurried to relieve the stress in the financial system and improve market functioning. Said Sack: "The mindset was that the Fed had to do everything it could to support the recovery, and these programs, as well as the liquidity facilities and other programs, had been introduced very quickly." The programs were closely monitored, he said:

> They were a new instrument that was going to be used in addition to the federal funds rate. From a policy perspective, it was a fascinating period to think about how that instrument worked and about how it should be used and how to adjust that usage to whatever situation was occurring at the time. That involves a lot of analysis and a lot of work by the Federal Reserve staff in the form of memos to the FOMC [Federal Open Market Committee], but also in conversations among a smaller set of policy makers who ultimately had to make recommendations to the FOMC.

In addition to the asset-purchase programs, the Federal Reserve added "forward guidance" to its arsenal of weapons to influence financial conditions and support economic growth. Sack observed,

> To this day, the FOMC notes that its tools are "forward guidance" and "asset-purchase programs." In this period, those two tools emerged and were used in ways that hadn't been used before. Their usage evolved over time during this period, but these were the two primary tools available.

There were some concerns about the cost of the programs and their form, given how quickly they were implemented. Yet, as the associated costs proved muted, the programs were more expanded and became more effective. Sack noted:

> In terms of their design, perhaps it is surprising that the set of programs ranged from such a large discrete program for QE1—a $1.75 trillion program announced upfront—to QE3—a monthly flow of purchases. The maturity extension program and QE2 were of intermediate sizes. The asset-purchase programs therefore took a number of different forms. In hindsight, we should try to learn about what's the best of those forms and what's the right way to implement them going forward. The practice has landed much more in the direction of QE3 in terms of specifying an open-ended flow of purchases. That was something that evolved over time across the program.

Bigger bank reserves are a risk-free liquid asset that can be used to fight the crisis.

A debate during the Global Financial Crisis that continues today is the expanding size of the central bank's balance sheet and whether it hamstrings the Fed's abilities to raise interest rates. Sack argued,

> By having a bigger balance sheet, the Fed ends up creating a bigger set of reserves in the banking system. Our view was, the banking system and the financial markets needed a large amount of reserves. Reserves are a very effective asset for the central bank to provide, since they are a risk-free liquid asset that the banking system can use for its liquidity management purposes. It's essentially costless for the central bank to provide it.
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> For those reasons, I thought the balance sheet shouldn't shrink too far. The way the market has evolved has essentially proved this right. In 2019, we saw some pressures begin to emerge in funding markets as reserve balances fell, and that happened earlier than people thought.

However, maintaining an expanded balance sheet is not without risks. Sack discussed this point:

> Some might argue that with the Fed holding a larger amount of government debt, and with government debt increasing, maybe there will come a time when the Fed feels compromised by the fiscal authority, where it can't raise interest rates because that would be too costly to the government, given the high levels of debt.
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> The root problem in that argument comes with the level of government debt more than the size of the Fed's balance sheet. And it involves the Fed becoming compromised in terms of its objectives.
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> The balance sheet is extremely big now, so it is a valid question to ask what happens from here. I would imagine that we're going to see something similar to what we saw after the financial crisis, and the Fed is not going to keep the balance sheet at this size

indefinitely. We'll go through a period where it shrinks the balance sheet back towards a more normal level.

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