

Discussion of Central Bank Losses as Private Sector Insurance

by Refet S. Gürkaynak, Burçin Kısacıkoglu, and Oreste Tristani

Anna Cieślak

Duke University, Fuqua School of Business, NBER, and CEPR

Central Bank of Ireland, Riksbank, DNB, Bundesbank
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To be tested: QE as insurance against duration risk from rate hikes

- ▶ QE removes duration risk from private (bank) B/S, injects interest-bearing reserves

Private duration gap $\xrightarrow{QE}$ CB duration gap

- ▶ CB realized losses due to rate hikes = private-sector losses that did not occur

Ex-post realized insurance; Good luck – QE happened to precede rate hike

Empirical groundwork: QE impacts long yields via term premia $\sim$ duration risk

Yield-curve transmission

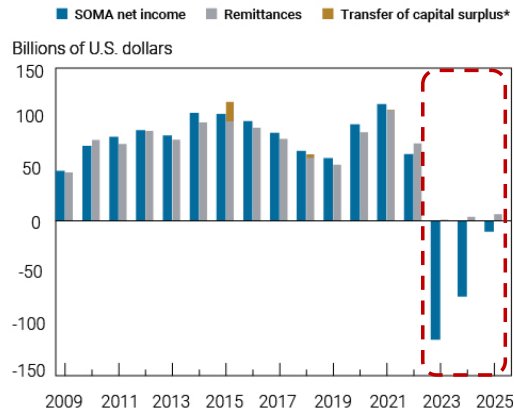
- ✓ Target $\rightarrow$ short end
- ✓ FG $\rightarrow$ expected rates
- ✓ QE $\rightarrow$ long end via **term premia** $\downarrow$
duration-extraction, not commitment

Financial stress

- ✓ Tightening $\uparrow$ stress (CISS)
- ✓ QE: no unconditional CISS effect
- ✓ QE: policy vs. info news
offsetting sovereign-stress effects

Fed losses

SOMA Net Income and Federal Reserve Remittances to the U.S. Treasury



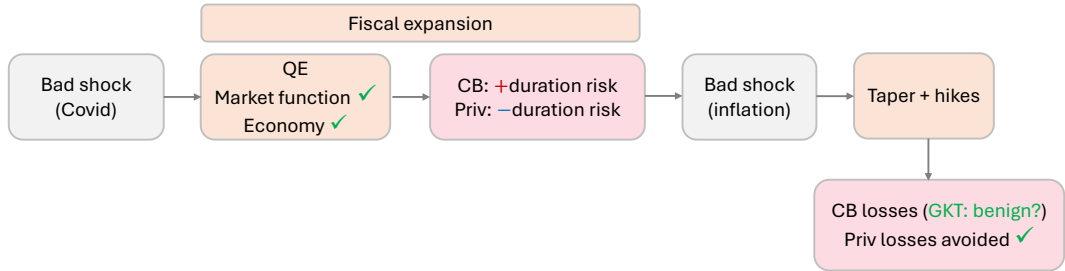
Source: Annual OMO report, 2025

SOMA Domestic Portfolio Unrealized Gains and Losses

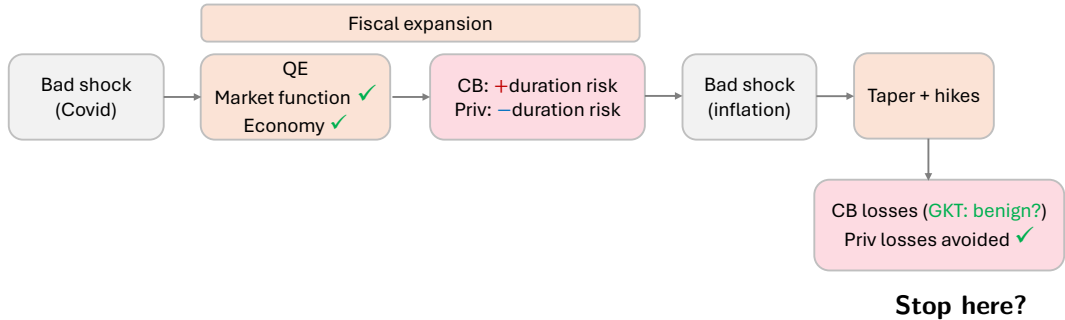
Billions of U.S. Dollars

Date	Treasury Securities	Agency MBS	Agency Debt	Total
2021	134.6	(7.4)	0.7	127.9
2022	(672.8)	(407.7)	0.2	(1,080.4)
2023	(585.2)	(363.3)	0.1	(948.4)
2024	(653.2)	(410.6)	0.1	(1,063.7)
2025	(535.3)	(309.1)	0.1	(844.2)

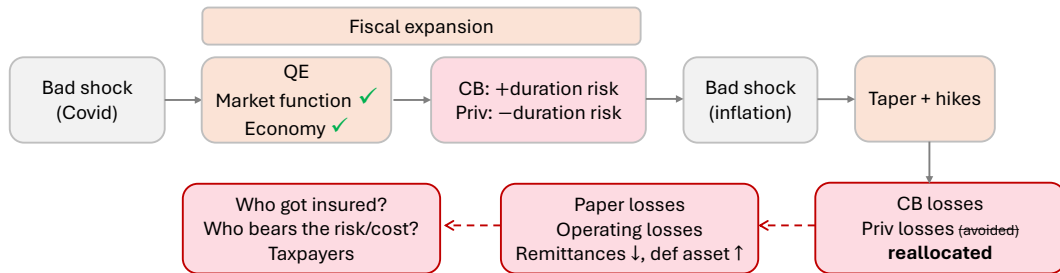
The insurance argument



The insurance argument



The insurance argument



CB losses do not disappear

Discussion

- ▶ Who got insured?
- ▶ Who paid for it?
- ▶ How large was the QE insurance effect?

Who was insured?

- ▶ Counterfactual: Who would have borne losses absent QE? [GKT emphasis: banks/intermediaries]
- ▶ Would it have been destabilizing? [GKT narrative: Implied yes]

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Some facts

- ▶ US banks not main direct Treasury duration holders, hold $\sim 3\text{--}4\%$ (Jansen-Li-Schmid'26)
- ▶ In 2020 Q1, mainly foreigners sold US longer Treasury (Gomez-Cram-Kung-Lustig'24, Vissing-Jorgensen'21)
 - ECB's QE purchases primarily from foreigners, not domestic banks (Koijen et al., 2017)
- ▶ Fed absorbed massive Treasury issuance; its pace of buying $>$ issuance 2020 Q2:Q4

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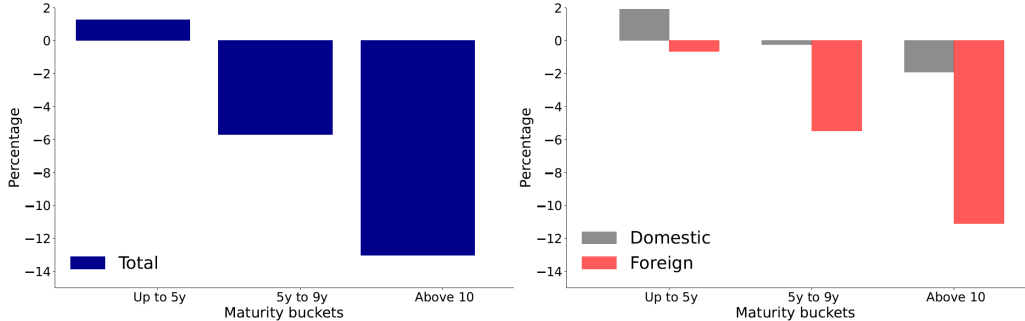
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Covid QE likely insured Treasury-market duration holders, but not necessarily banks

Foreigners sold big in Covid

Change in institutional investor holdings of US bonds and notes, 2020Q1



Notes: Change in holdings of U.S. Bonds and Notes as a percentage of total holdings in each maturity bucket. The right panel separates the change in Treasury holdings into foreign and domestic investors. The changes shown are for 2020Q1. Based on EMAXX Holdings data.

Source: Gomez-Cram-Kung-Lustig'24

Back-of-envelope: Bank insurance from QE

- ▶ Fed's unrealized SOMA losses peaked at ~**\$1T** in 2022–23
- ▶ Suppose Banks held **5–10%** of Treasuries and sold all (*generous upper bound*)

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- ▶ Banks' share $\leq 10\%$ of SOMA losses
- ▶ Bank duration losses avoided:
\$50–100B
- ▶ Remainder absorbed by non-banks

What remained exposed

- ▶ Banks' mark-to-market losses 2022–23:
\$2.2T Jiang-Matvos-Piskorski-Seru'24: RE loans, MBS, CMBS, ABS, Treasuries still held
- ▶ ~**96%** of pre-hike aggregate bank capitalization

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Implications: CB losses $\neq$ bank losses avoided

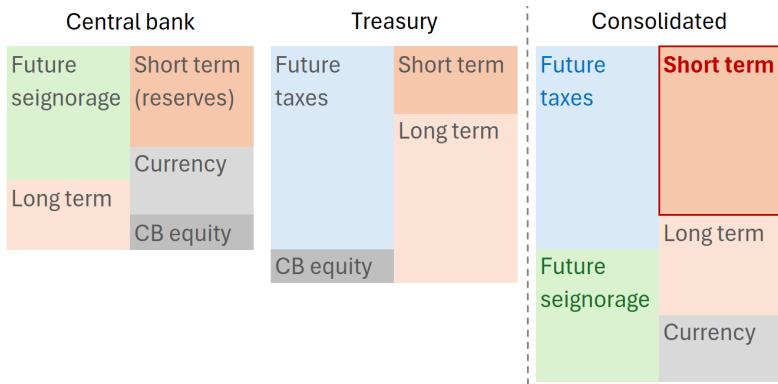
- ▶ QE likely insured small part of bank duration exposure: ~2–5% of actual losses

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- ▶ Risk doesn't disappear from CB B/S → shifts to taxpayers (Cecchetti-Hilscher'24)
- ▶ QE shortens duration of consolidated B/S → **interest-rate refi risk for taxpayers**
(d'Avernas-Hubert de Fraisse-Ning-Vandeweyer'26)



- ✓ QE is welfare-improving duration-extraction policy
 - Monetary-dominance view (d'Avernas et al.'26)
 - Ex-ante NPV > 0: Ex-ante costs $\sim 0.25\text{--}0.69\%$ GDP < output benefit 1.2% GDP
 - But realized losses can be large: 6.7% GDP in 95 pctile tail event
- ✗ Taxpayer cost of protecting bondholders
 - Fiscal-dominance view (Gomez-Cram-Kung-Lustig'24)
 - After large unfunded fiscal expansion, QE provided price support to bondholders
 - Delayed rational markdown at taxpayer expense

QE term premium insurance: How large?

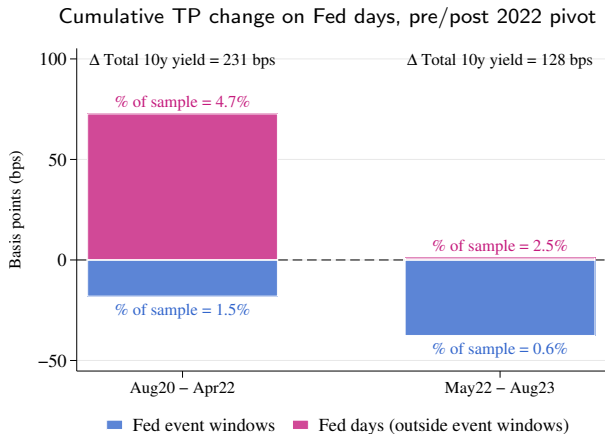
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Fed contributed about 1/3 of term premium rise through 2022



- ▶ 10y yield rose **359 bps** (2020:8–23:8)
 - ▶ Pre-2022 pivot, Fed **added 73bps (32%)** via TP *despite QE*
 - ▶ Post-2022 pivot, Fed **offset 34bps (-27%)** via TP *despite QT*
- (Cieslak, McMahon, Pang'25)

- ▶ Markets priced uncertainty about Fed's reaction function
- ▶ Any effect of QE on TP was offset by Fed's communication: insurance short-lived

- ▶ **Who pays?** CB losses do not disappear; transfer of duration/refinancing risk to consolidated public sector
- ▶ **Who benefits?** May not be banks; foreigners, mutual funds, hedge funds, ...
- ▶ **How large?** Need counterfactual sectoral allocation of duration risk absent QE, not just “bank duration gaps”

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Ex-post one-off insurance (good luck) $\neq$ ex-ante insurance policy (good policy?)
CB credibility as fiscal asset, moral hazard, Fed put ...