

Remember QE? It's here to stay. Only this time it has t...

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The [FT has reported this morning](#) that the US Fed has backtracked on its commitment to shrink its balance sheet.

Over the last year or so the Fed has been shrinking its balance sheet at the rate of approximately \$50 billion a month. This means that it has effectively been selling old Treasury bonds back into the US market, which has had the effect of taking excess liquidity out of that economy to reduce the threat of inflation. What it has now said is that this policy will end during the course of this year. Given that this is a significant change of tack, what's the likely real reasoning? I suggest three things.

First, and glaringly obviously, the Fed thinks that we are heading for a recession, and in that case there is absolutely no reason at all to take cash out of the US economy.

Second, the threat of US inflation is also receding, and there is, therefore, no reason to still do this.

And third, perhaps as important as both the previous reasons, the Fed has realised that the fiscal stimulus created by Donald Trump's absurd corporate tax refund program is coming to an end, and the excess flows of cash that it pumped into the economy, which quantitative tightening was having to withdraw from circulation, are coming to an end. In other words, the Fed's need to counter Trump's policies is receding.

But, that said there is more to this than these short-term issues. Remember that the UK has yet to reverse any QE (or pursue Quantitative Tightening (QT), as it is called). And the EU is nowhere near doing so, and nor come to that is Japan. So the Fed has been the outlier here. That, I suggest, is largely because of the need to counter the harmful impact of the Trump corporate tax refund. Take that one factor out of account and the message is that QE is here to stay.

But it will stay in a new form. Central bankers are realising that conventional monetary policy is dead in the water. The US has also reached the end of the road on interest rate rises, in my opinion, and there is very little chance of them in the UK or EU. So in that

case their only tool is QE, and QT. And in the absence of governments willing to undertake conventional fiscal policy, which is what should be happening, central bankers will be forced to use QE and QT to try to balance the economy in the future.

Of course I would prefer fiscal policy. It is what we need.

But if we are to have a policy of QE and QT as a substitute fiscal policy then the very least that central bank should do is make it green QE matched with conventional QT, which is a policy mix that is entirely open to them given their current balance sheet composition.

Of course, it would be better still to realise that the core elements of MMT, managed from a Treasury, provides a better answer, but that day has yet to come.