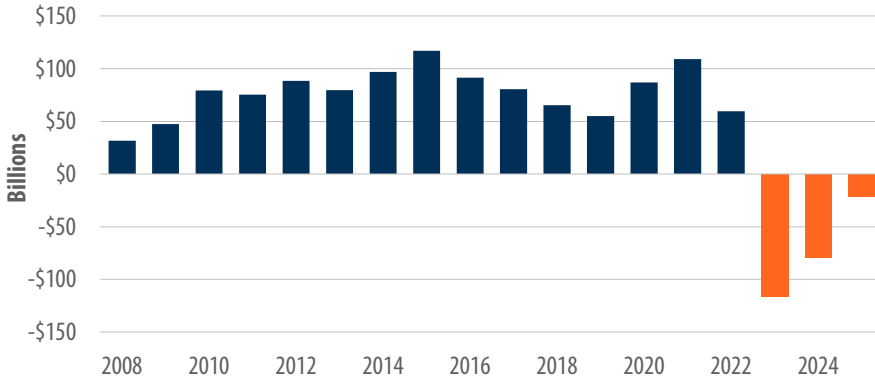


The Fed's 2025 Financials: Shrinking Losses, Still Massive

In this week's edition of "Three on Thursday," we look at the Federal Reserve's financials through year-end 2025. Back in 2008, the Federal Reserve (the "Fed") embarked on a novel experiment in monetary policy by transitioning from a "scarce reserve" system to one characterized by "abundant reserves." In addition to inflation, this experiment has resulted in some other developments that are worrisome. Higher interest rates have resulted in substantial unrealized losses on the Fed's securities portfolio. Simultaneously, they have caused the Fed to pay out more in interest to banks than it is earning, resulting in sizable and ongoing losses. However, there are signs of improvement. As interest rates stabilize and the balance sheet contracts, these losses have begun to narrow, though they remain historically large. To offer deeper insights into where things stood at the end of last year, we have included the two charts and table below.

Net Earnings Remittances to the Treasury



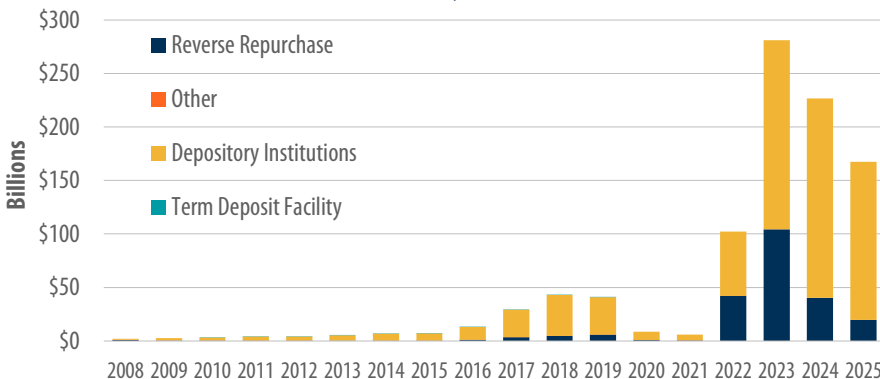
Source: Federal Reserve Board, First Trust Advisors. Annual data 2008-2025.

Domestic SOMA Portfolio Holdings (in Millions)

Treasury Securities	Amortized Cost	Fair Value	Cumulative Unrealized Gains/Losses
Bills	\$231,485	\$231,604	\$119
Notes	\$2,242,469	\$2,165,444	-\$77,025
Bonds	\$1,916,249	\$1,457,894	-\$458,355
Total Treasury Securities	\$4,390,203	\$3,854,942	-\$535,261
Federal Agency and GSE MBS			
Residential	\$2,069,402	\$1,761,250	-\$308,152
Commercial	\$8,221	\$7,306	-\$915
Total Federal Agency and GSE MBS	\$2,077,623	\$1,768,556	-\$309,067
GSE Debt Securities	\$2,449	\$2,634	\$135
Total Domestic SOMA Portfolio Securities Holdings	\$6,470,275	\$5,626,132	-\$844,193

Source: Federal Reserve Board, First Trust Advisors. Data as of 12/31/2025. The domestic portfolio holdings of the Federal Reserve's System Open Market Account (SOMA). GSE stands for Government Sponsored Entity.

Interest Paid to Banks and Institutions by the Federal Reserve



Source: Federal Reserve Board, First Trust Advisors. Annual data 2008 - 2025.

Before 2022, the Fed was able to buy Treasury and mortgage-backed securities (MBS) that generated higher yields than what they were paying banks. Consequently, the Fed consistently earned substantial operating surpluses, which were then remitted to the Treasury Department on a weekly basis. Over a span of 15 years, the Fed contributed an average of over \$75 billion annually to government revenue through this mechanism. But now, even with the 75 basis point reduction in the Fed funds rate last year, it's still paying banks 3.65% per annum to hold reserves – more than what it earns from its portfolio of Treasury bonds and MBS. These higher rates led to \$21 billion in losses over 2025. These accumulated losses are called a deferred asset on the Fed's balance sheet and will only be paid off/when the Fed starts to make a profit again down the road. This deferred asset, which represents all accumulated losses so far, stood at \$243 billion at the end of 2025.

At the end of 2025, the Fed had a \$844 billion unrealized loss on its balance sheet, but it's important to note the unique position it's in. Unlike many financial institutions, the Fed doesn't face solvency concerns because it's not required to mark its portfolio to market values. The Fed has the option to hold its securities until they mature, and there's no regulatory agency that can intervene and force it to shut down due to accounting losses. With total reported capital of just \$46 billion at the end of 2025, the Fed's unrealized loss of \$844 billion represents 18 times its capital.

In 2025, the Federal Reserve paid banks and financial institutions roughly \$167 billion in interest on reserve balances—down from \$227 billion in 2024, but still an extraordinarily large sum of risk-free income ultimately borne by taxpayers. Looking ahead, market pricing suggests the Fed funds rate is likely to remain unchanged in 2026, while the Federal Reserve itself projects a modest 25 basis point cut. Even with rates holding steady or drifting slightly lower—and with continued balance sheet runoff—interest expenses could decline further, as they did in 2025. But the drop is marginal relative to the scale. We estimate the Fed will still pay between \$125 billion and \$175 billion in 2026, underscoring that these sizable transfers to the banking system are not going away anytime soon.

This report was prepared by First Trust Advisors L.P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.