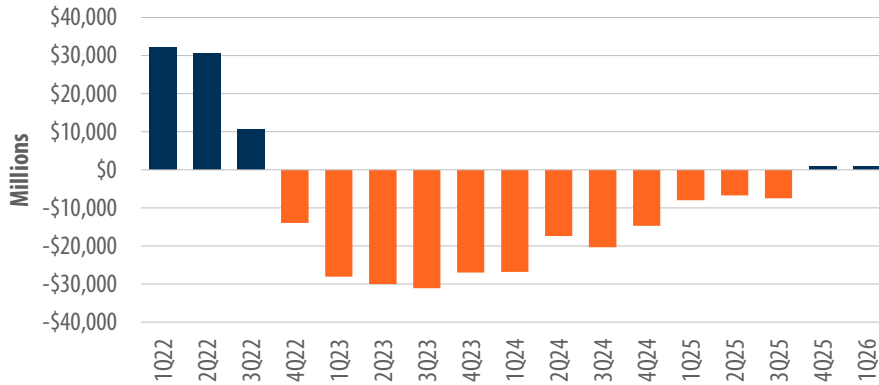


Fed Q1 2026 Financials: Finally Turning the Corner?

In mid-May, the Federal Reserve (the “Fed”) released its latest quarterly financial report for Q1 detailing the combined financial position of the 12 Federal Reserve Banks. In this week’s edition of “Three on Thursday,” we take a closer look at what the report reveals. Since 2008, the Fed has operated under an “abundant reserves” framework, a significant departure from its prior monetary policy approach. While the Fed believes this system helped support financial markets and economic activity, it has also produced some notable side effects. Higher interest rates have generated substantial unrealized losses on the Fed’s securities portfolio and, for years, caused the Fed to pay more in interest on reserves than it earned on its assets, resulting in sizable operating losses. There are, however, signs of improvement. As interest rates have somewhat stabilized and the Fed’s balance sheet has gradually contracted, those losses have narrowed and the Fed returned to modest profitability over the past two quarters. For additional perspective, see the table and two charts below.

Net Earnings Remittances to the Treasury



Source: Federal Reserve Board, First Trust Advisors. Data from first quarter 2022 through first quarter 2026.

Before 2022, the Fed consistently earned more on its Treasury and mortgage-backed securities portfolio than it paid banks on reserve balances. That changed as interest rates rose. After 12 consecutive quarters of losses, which were recorded as a deferred asset on the Fed’s balance sheet, the past two quarters have shown modest improvement. In Q1 2026, the Fed reported net remittances to the Treasury of \$949 million, yet its deferred asset still grew by \$459 million to \$243.9 billion. How is that possible? The Fed’s return to remittances does not mean the system has worked through its accumulated losses. Rather, it reflects a growing divide among the 12 Reserve Banks. Some have returned to profitability, fully eliminated their deferred assets, and resumed remitting earnings to the Treasury, while others continue to incur losses and add to their deferred assets. As a result, the Treasury received \$949 million in net remittances during the quarter even as the Fed’s consolidated deferred asset increased. Today, only three of the twelve Reserve Banks are profitable enough to remit earnings, while the remaining nine continue to operate at a loss.

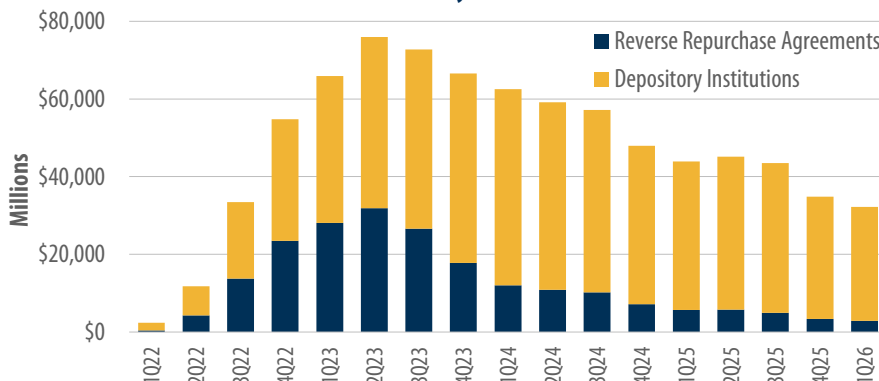
Federal Reserve’s Portfolio Holdings (in millions)

Treasury Securities	Amortized Cost	Fair Value	Cumulative Unrealized Losses
Bills	\$392,830	\$392,801	-\$29
Notes	\$2,244,147	\$2,164,363	-\$79,784
Bonds	\$1,909,448	\$1,443,256	-\$466,192
Total Treasury Securities	\$4,546,425	\$4,000,420	-\$546,005
Federal Agency and GSE MBS			
Residential	\$2,026,009	\$1,716,154	-\$309,855
Commercial	\$8,115	\$7,211	-\$904
Total Federal Agency and GSE MBS	\$2,034,124	\$1,723,365	-\$310,759
GSE Debt Securities	\$2,491	\$2,597	\$106
Total Domestic SOMA Portfolio Securities Holdings	\$6,583,040	\$5,726,382	-\$856,658

Source: Federal Reserve Board, First Trust Advisors. Data as of first quarter of 2026. The domestic portfolio holdings of the Federal Reserve’s System Open Market Account (SOMA). GSE stands for Government Sponsored Entity.

As of the first quarter of 2026, the Federal Reserve carried \$856.7 billion in unrealized losses on its balance sheet. While striking, these losses do not raise solvency concerns for the Fed in the way they would for private institutions. Unlike commercial banks, the Fed is not required to mark its securities to market, nor is it subject to regulatory capital requirements. 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 reported capital of just \$46.4 billion, the unrealized losses are roughly 18 times the Fed’s capital. Although still extreme this is an improvement from just a few years ago when unrealized losses approached \$1.1 trillion.

Interest Paid to Banks and Institutions by the Federal Reserve



Source: Federal Reserve Board, First Trust Advisors. Data from first quarter 2022 through first quarter 2026.

In the first quarter of 2026, the Federal Reserve paid banks and other financial institutions \$32.2 billion in interest on reserve balances, down from \$43.9 billion a year earlier and the lowest quarterly total since mid-2022. While interest expenses are moving in the right direction, they remain extraordinarily high. Market pricing currently suggests the Fed funds rate could rise by 25 basis points by year-end, while the Fed itself projects a 25 basis point cut. Regardless, continued balance sheet runoff should help reduce interest expenses further. Even so, we estimate the Fed will pay between \$100 billion and \$150 billion in interest on reserves in 2026, highlighting that these large, risk-free transfers to the banking system are likely to persist for years to come.

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.