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US FED: Kohn Says FOMC Could Sell Assets If Spreads Are Distorted

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Washington, September 30 -
Federal Reserve Vice Chairman

Donald Kohn said in comments

today at the **Cato** Institute in Washington that in the course of removing accommodative monetary policy, the [Federal Open Market Committee](#) could decide to sell its holdings of mortgage-backed and agency securities if it 'perceives spreads to be distorted or longer-term [interest rates](#) to be not responding appropriately.'

Yet Kohn seemed to indicate this move would be unlikely for a number of factors. He noted that some of the spread compression may result from the flow of purchases, which the Fed has already announced it will be tapering. 'Moreover, the stock of assets we own will become an ever smaller share of a growing market.' Kohn added that as confidence returns, 'asset demands will become less focused on particular classes of highly safe and liquid assets and more sensitive to relative interest rates, and private participants will arbitrage away at least some of any remaining spread distortions.'

Kohn said the Fed is fully equipped to exit from its accommodative policy when needed. He pointed to the Fed's ability to pay interest on reserves, which he said 'will enable us to raise short-term interest rates even while the quantity of assets we hold is still quite elevated and while the reserve base of the banking system is extraordinarily high.' Further, when the Fed begins to raise rates, 'it will put upward pressure on the rates on competing assets, increasing actual and expected short-term interest rates with the usual types of effects on other interest rates and asset prices,' Kohn said.

Elsewhere he cautioned against waiting too long to withdraw policy. 'We must begin to withdraw accommodation well before aggregate spending threatens to press against potential supply, and well before inflation as well as inflation expectations rise above levels consistent with price stability.'

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