BNY

iFlow

SHORT THOUGHTS

August 13, 2024

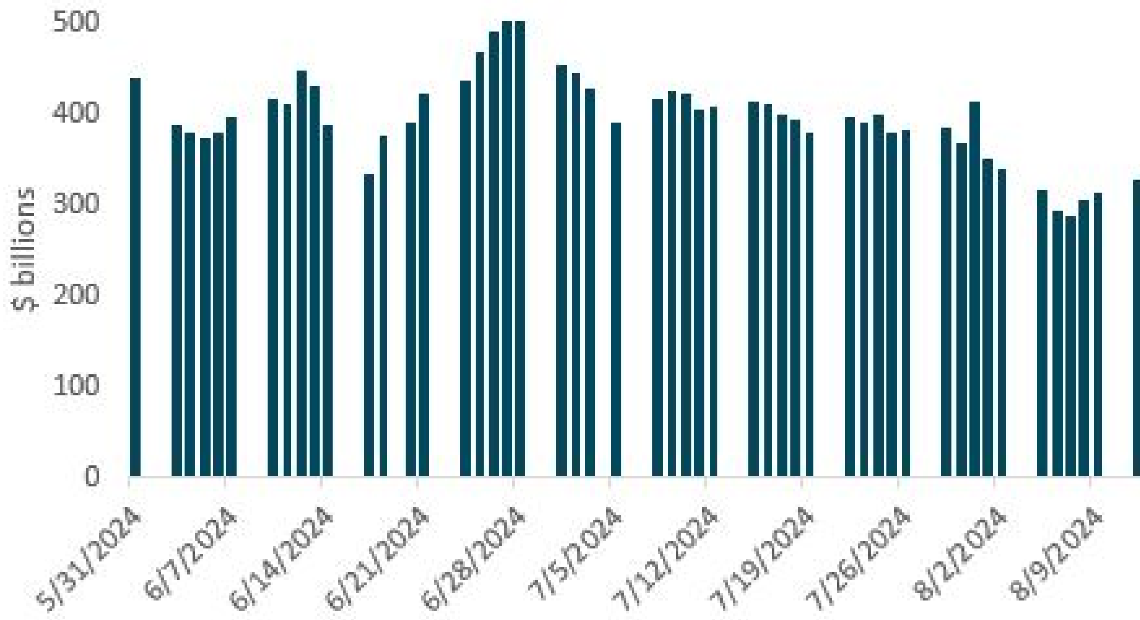
How Low Will RRP Go?

- RRP is holding steady as T-bill rates fall well below offering rate
- If RRP stays elevated, QT can continue to run
- iFlow shows strong demand for cash, retreat from UST by cross-border investors

Assets held in money market mutual funds (MMFs) as of last Wednesday, according to Investment Company Institute (ICI) data, were nearly $6.2trn. According to Crane Data, through last Friday total MMF assets were even higher, at around $6.5trn, both record highs. At the same time, T-bill yields have fallen to levels well below the offering rate at the New York Fed's overnight reverse repo facility (RRP) of 5.3%. The current 3m bill rate is only 5.21%, while the OIS swap rate is a mere 5.1%. As a result, the RRP drain we have observed since the end of May, from around $500bn down to around $300bn, where it has remained for most of the month of August.

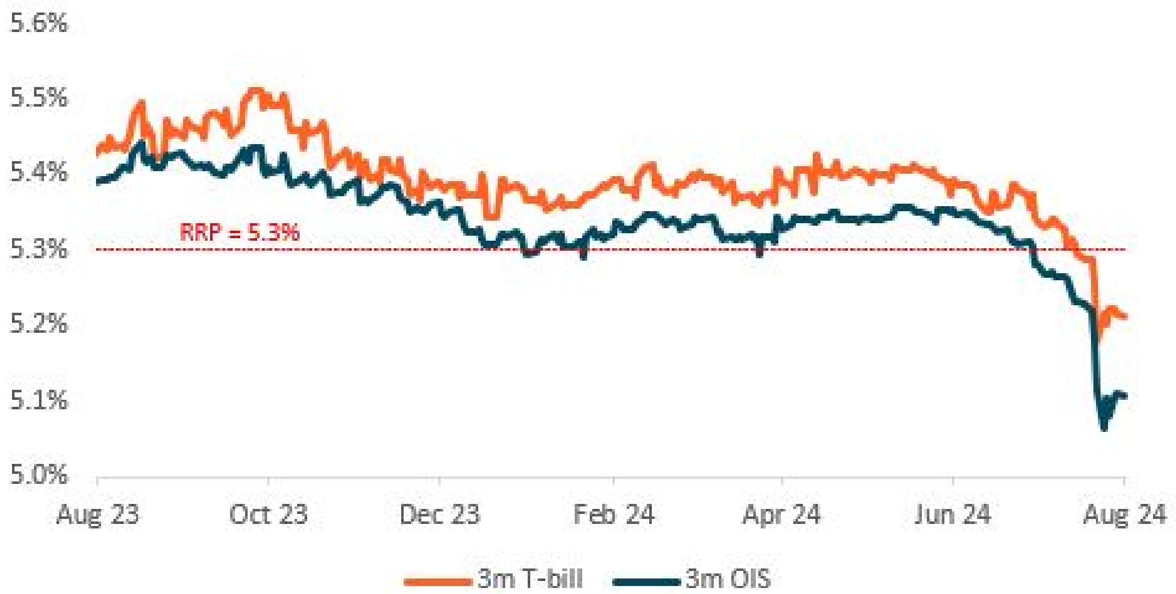
The first of the two charts below shows the pace of RRP take-up over this period, and we can see a fairly steady decline toward the above-mentioned $300bn. With longer-date yields falling below the current RRP offer rate of 5.3%, as we show in the second chart, we think portfolio choice considerations have prevailed upon the MMFs to keep a steady portion of their assets in the RRP facility.

RRP Stalls Around $300bn



Source: BNY Markets, Federal Reserve Bank of New York

T-bills Below RRP Offer Rate



Source: BNY Markets, Bloomberg

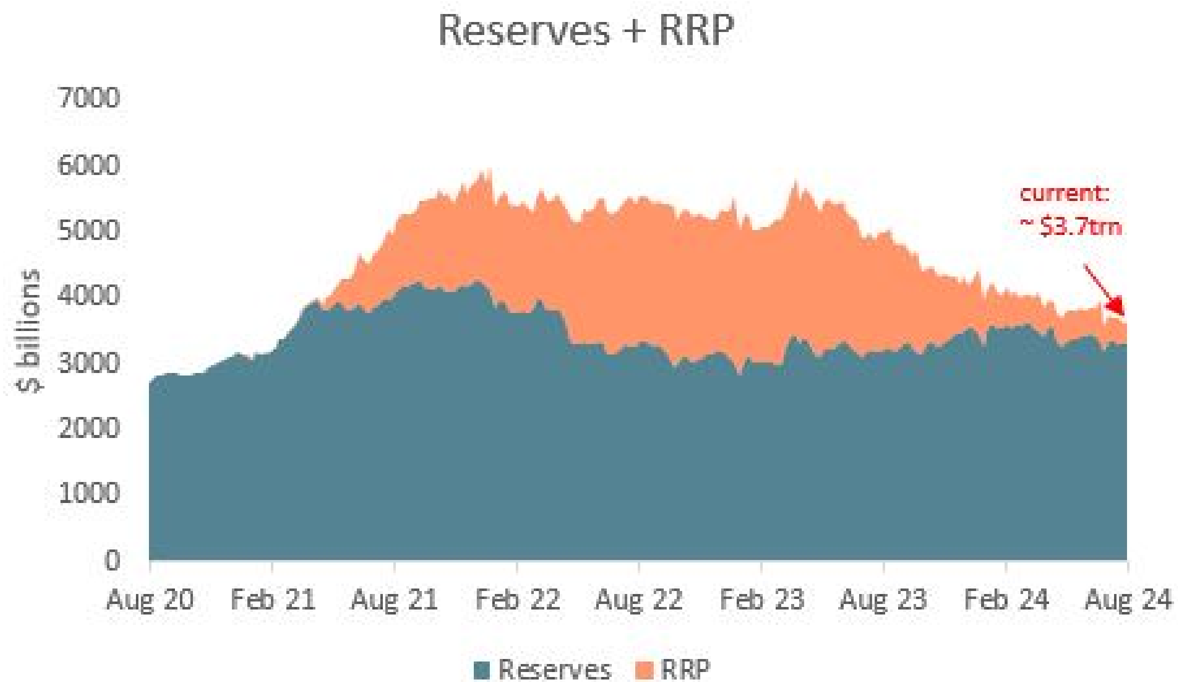
With an FOMC rate cut likely on September 18, we expect longer-date bills to remain relatively unattractive. Of course, a 25bp cut – which we think is more likely than a “jumbo” cut of 50bp – of the federal funds rate, the RRP rate will likely drop by the same amount, down to 5.05%. In this case, the outlook for rates after that will be important to T-bill yields further out the curve, and by extension RRP usage.

In this scenario, the outlook for the real economy and inflation – as well as the dots submitted by FOMC participants at the September meeting via the Summary of Economic Projections – will be crucial for determining the outlook for rates, hence the level of T-bill rates and ultimately the expectation for RRP usage into the autumn. This in turn has implications for the future of quantitative tightening.

If RRP drainage stalls above, say, $200bn, QT may indeed continue at its current $25bn per month pace until reserves have fallen from their current “abundant” state to merely “ample,” at which point we suspect QT will finally have to cease. A rule of thumb – and merely that, as opposed to a point forecast – is that when the sum of total system bank reserves plus RRP usage falls to around $3trn, this transition from abundant to ample reserves will have occurred. The chart below shows that at present, adding these two quantities yields a level (as of last Wednesday) of around $3.7trn, so there is still room for QT to persist – probably into year-end.

Should RRP drainage resume and balances dip under $200bn, we’ll have to pay close attention to reserves, as a retreat below $3trn (they are currently $3.35tn), would threaten the abundant reserves regime, and we could see liquidity problems emerge as it transitions from abundant to ample.

Total Liquidity Still Abundant



Source: BNY Markets, Federal Reserve Bank of New York, Board of Governors of the Federal Reserve System

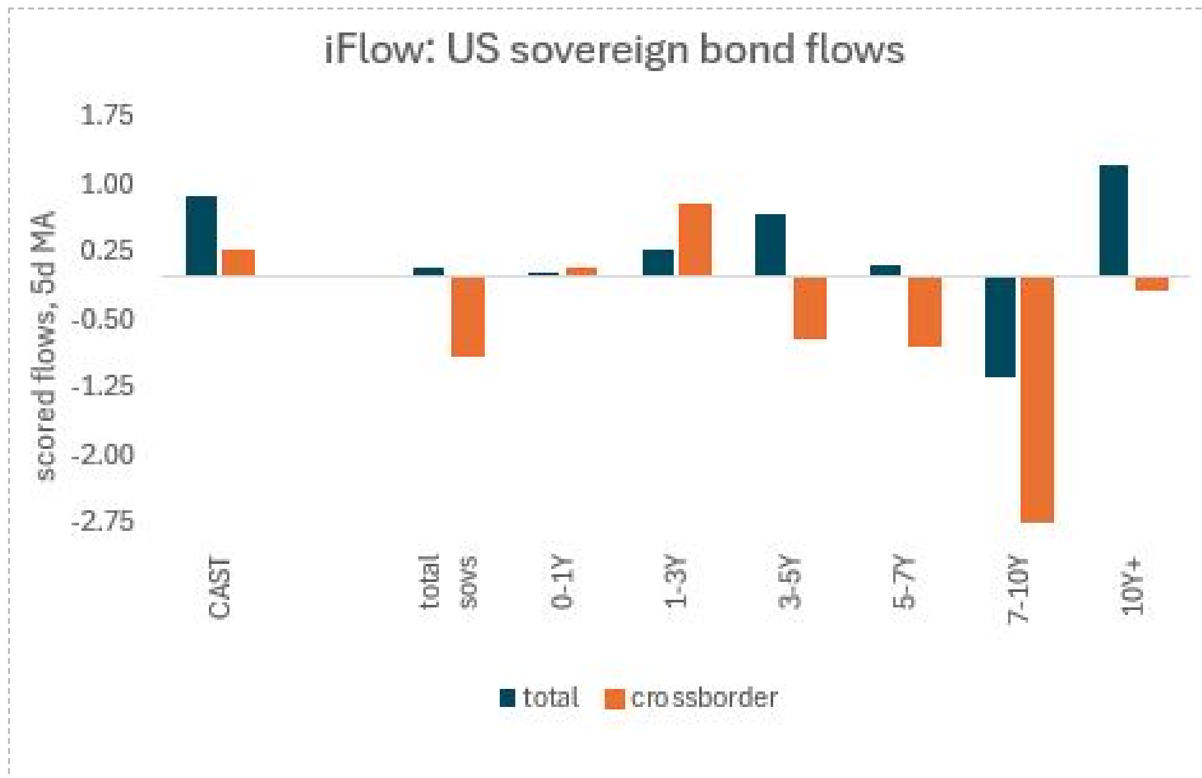
---

MMFs' weighted average maturities (WAMs) are holding steady at around 34-35 days, and WAMs for Treasury-only funds remain just above 40days. There has not been, even during the period of market volatility over the past two weeks, an extension into longer parts of the bills curve, probably because – as stated above – T-bill rates remain below the 4.3% RRP offer rate. Repo volumes have not spiked during this period either and repo rates have remained well behaved, all speaking to abundant cash still in the system.

Real money and long-only asset managers' demand for cash has increased in recent days however, in response to the volatility, and our iFlow data confirm this. Below we re-post a chart from our Monday Macro Morning Briefing (see here). It shows significant cross-border selling of longer-dated US Treasuries, a general move into shorter-date USTs, and a significant increase in cash and other short-term assets (CAST). At over 1 standard deviation above normal, this is the largest five-day rush into CAST since November 2023. Before that one has to go back to 2018 to see similarly large flows into cash.

These data speak to the rush to quality engendered by the recent bout of market volatility. The retreat of cross-border participation in the longer end of the curve is also concerning for UST liquidity. iFlow remains useful in providing us with alternative insights into risk averse behavior by market participants.

Cross-border Flows Fall, Cash Holdings Increase



Source: BNY Markets, iFlow

Please direct questions or comments to: iFlow@BNY.com

John Velis

AMERICAS MACRO STRATEGIST

CONTACT JOHN

Can't see the email? View online

iFlow

We can gauge how the world's money moves.
Because a fifth of it moves through us.

Learn More

Contact Us

We take our data protection and privacy responsibilities seriously and our privacy notice explains how we collect, use, and share personal information in the course of our business activities. It can be accessed here.

This email was sent to WeeKhoon.Chong@bnymellon.com, and was sent by The Bank of New York Mellon 240 Greenwich Street, New York NY 10286.

Your privacy is important to us. You can opt out from receiving future Newsletters by unsubscribing via this link at any time. You can also select the topics that you want to receive by managing your preferences.

This message was sent from an unmonitored email box. Please do not reply to this message.

Contact Us | iflow@bny.com

© 2023 The Bank of New York Mellon Corporation. All rights reserved.

This message was sent from an unmonitored email box. Please do not reply to this message.

.