

January 23, 2024

Fed's Discount Window In The Spotlight

Trying To Remove The Stigma

- Regulators to require banks to use the discount window once a year
- If stigma to use it fades, the window could become a crucial tool if liquidity falls
- T-bill curve inverted, pricing in rate cuts; how will MMFs respond?

Discount Window Changes Coming

Last week, the Federal Reserve and two other US regulators, the Office of the Comptroller of the Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC), were said to be putting together a plan to require eligible banks to use the discount window at least once a year. Among other things, this regulation – currently in development – is being positioned as a way to reduce the stigma often associated with banks' participation in the facility.

Furthermore, such intermittent use, even for small amounts, is aimed at making sure that a bank that does need to access the window can do so from an operational perspective.

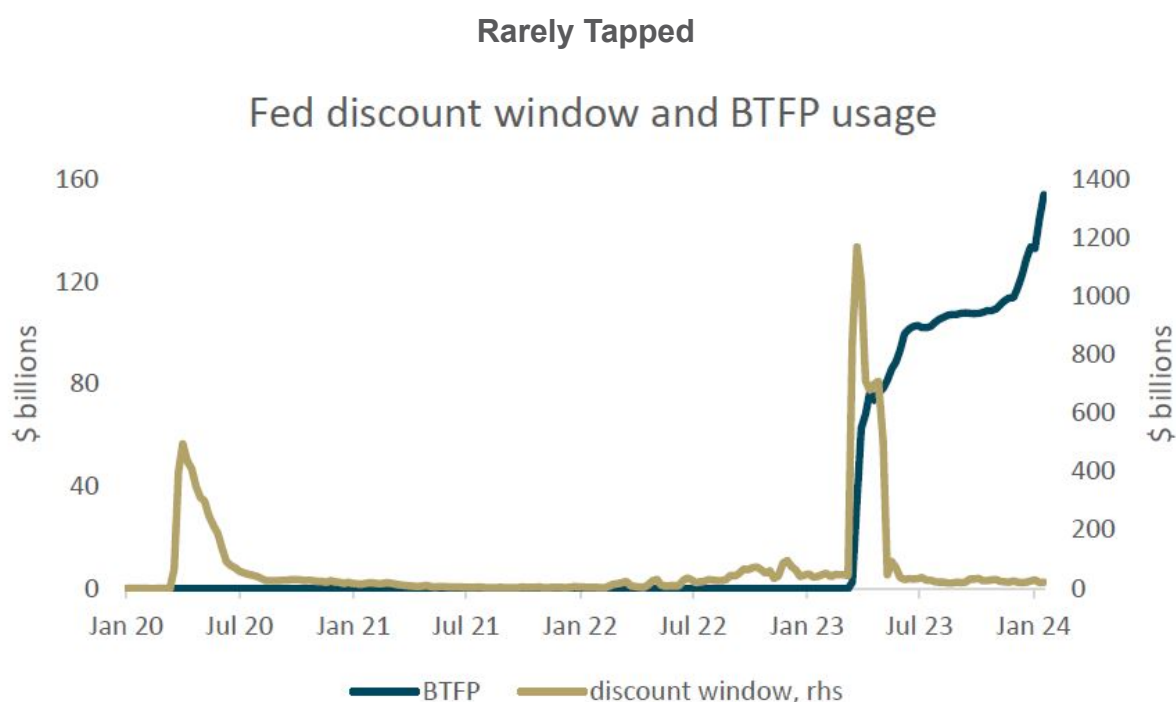
This discount window is rarely used, in large part due to stigma concerns. Investors – and more importantly, depositors – could view such use of the facility in a negative light, for example, an indication that the borrowing institution is somehow under stress. Furthermore, the current interest it charges against eligible collateral is 5.5%, much higher than the 4.91% borrowing rate on the soon-to-be mothballed Bank Term Funding Program (BTFP) that was set up to address the regional banking strains of last spring. Fed Vice Chair for Supervision Barr indicated that the BTFP will not be extended after it expires on March 11. As swap spreads have come in and the borrowing rate has fallen, BTFP usage – which also has generous collateral valuations associated with it – has risen in recent weeks as institutions exploit an arbitrage between BTFP rates and those available elsewhere in short-term markets (see [here](#) for a discussion of the BTFP's final days).

The most recent use of the window was in the immediate weeks after the COVID lockdowns were put in place; its use was encouraged by the Fed. After liquidity concerns had been addressed during the lockdowns, discount window usage dropped to nearly zero. However, as can be seen in the chart below, it ramped up again last March while the BTFP was getting set up and running. Use of the discount window presently is limited.

We think that this proposed regulatory setup – to require banks to do occasional operations at the window – was inevitable. At least since the pandemic, Fed officials have frequently noted in public remarks with reference to the discount window that it was available for liquidity needs, trying to reduce the stigma with which it’s associated. Furthermore, if the discount window does become destigmatized over time, it could serve as a useful funding vehicle for banks that have temporary (or more long-lasting and severe) liquidity needs. If it eventually gets regular use, it could alleviate pressure on reserves over time.

Remember also the Standing Repo Facility. This was set up when the latest bout of quantitative tightening (QT) was announced in June 2022, also stands ready to lend against Treasuries and Agency securities in times of need, and probably has a stigma attached to it, too. We have seen a fairly small (if slowly growing) list of signed-up counterparties.

We wonder if by trying to destigmatize the discount window, the Fed is also making sure that it is operational if needed. The Fed has already “talked about talking about” slowing the pace of QT, something we also commented on recently. Is the Fed preparing both the pipes and the optics of discount window usage because it may eventually be needed? After all, it was Dallas Fed President (and NY Fed veteran) Logan who mused if reserves were sufficiently unevenly distributed amongst member banks as a reason to consider reining in QT.

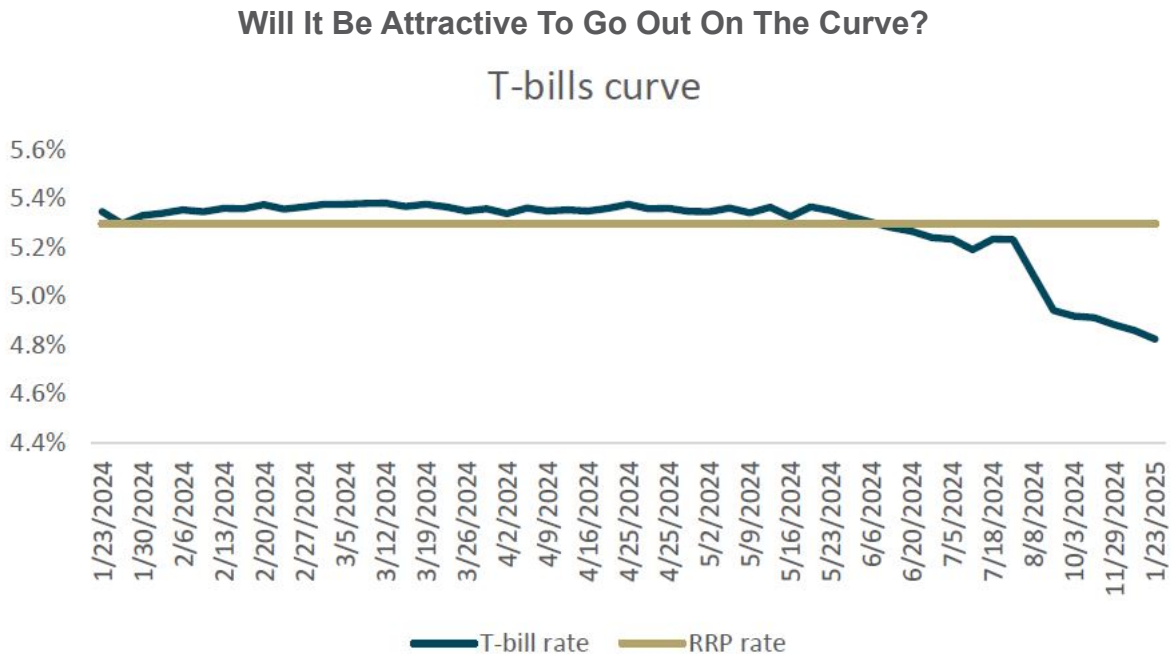


MMFs Facing Inverted T-bill Curve

The T-bill curve is inverted. Issues maturing past late-May are offering lower yields than the rate paid by the Fed on its overnight Reverse Repo operations (RRP). Obviously, this reflects the expectation of eventual rate cuts, and June is a reasonable representation of current market consensus, even if we have an earlier start in mind.

But with these later-date securities now offering yields below the RRP's 5.3%, would money market mutual funds (MMFs) be likely candidates to buy them, especially at the same clip that they have been since the middle of last year after the debt ceiling was postponed? In a yield-sensitive marketplace, how many bills can MMFs buy that pay less than RRP and have substantially longer duration?

According to Crane Data, the average weighted average maturity (WAM) of the Crane Money Fund Average index was 38 days on Jan. 19, 2024. We doubt WAMs will go much higher given the expectation of Fed rate cuts at some point, and the chance that cuts could be brought forward to May or March (the latter as we believe). MMFs might begin exercising caution when buying shorter-dated assets on the T-bill curve if they think rates could suddenly lurch lower. They will be following the macro data as well.



bnymellon.com

BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may be used as a generic term to reference the corporation as a whole and/or its various subsidiaries generally. This material and any products and services may be issued or provided under various brand names in various countries by duly authorized and regulated subsidiaries, affiliates, and joint ventures of BNY Mellon, which may include any of the following. The Bank of New York Mellon, at 225 Liberty St, NY, NY USA, 10286, a banking corporation organized pursuant to the laws of the State of New York, and operating in England through its branch at One Canada Square, London E14 5AL, UK, registered in England and Wales with numbers FC005522 and BR000818. The Bank of New York Mellon is supervised and regulated by the New York State Department of Financial Services and the US Federal Reserve and authorized by the Prudential Regulation Authority. The Bank of New York Mellon, London Branch is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV, a Belgian public limited liability company, with company number 0806.743.159, whose registered office is at 46 Rue Montoyerstraat, B-1000 Brussels, Belgium, authorized and regulated as a significant credit institution by the European Central Bank (ECB), under the prudential supervision of the National Bank of Belgium (NBB) and under the supervision of the Belgian Financial Services and Markets Authority (FSMA) for conduct of business rules, and a subsidiary of The Bank of New York Mellon. The Bank of New York Mellon SA/NV operates in England through its branch at 160 Queen Victoria Street, London EC4V 4LA, UK, registered in England and Wales with numbers FC029379 and BR014361. The Bank of New York Mellon SA/NV (London Branch) is authorized by the ECB and subject to limited regulation by the Financial Conduct Authority and the Prudential Regulation Authority. Details about the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV operating in Ireland through its branch at 4th Floor Hanover Building, Windmill Lane, Dublin 2, Ireland trading as The Bank of New York Mellon SA/NV, Dublin Branch, is authorised by the ECB and is registered with the Companies Registration Office in Ireland No. 907126 & with VAT No. IE 9578054E. The Bank of New York Mellon, Singapore Branch, subject to regulation by the Monetary Authority of Singapore. The Bank of New York Mellon, Hong Kong Branch, subject to regulation by the Hong Kong Monetary Authority and the Securities & Futures Commission of Hong Kong. If this material is distributed in Japan, it is distributed by The Bank of New York Mellon Securities Company Japan Ltd, as intermediary for The Bank of New York Mellon. If this material is distributed in, or from, the Dubai International Financial Centre ("DIFC"), it is communicated by The Bank of New York Mellon, DIFC Branch, regulated by the DFSA and located at DIFC, The Exchange Building 5 North, Level 6, Room 601, P.O. Box 506723, Dubai, UAE, on behalf of The Bank of New York Mellon, which is a wholly-owned subsidiary of The Bank of New York Mellon Corporation. This material is intended for Professional Clients only and no other person should act upon it. Not all products and services are offered in all countries.

The information contained in this material is intended for use by wholesale/professional clients or the equivalent only and is not intended for use by retail clients. If distributed in the UK, this material is a financial promotion.

This material, which may be considered advertising, is for general information purposes only and is not intended to provide legal, tax, accounting, investment, financial or other professional advice on any matter. This material does not constitute a recommendation by BNY Mellon of any kind. Use of our products and services is subject to various regulations and regulatory oversight. You should discuss this material with appropriate advisors in the context of your circumstances before acting in any manner on this material or agreeing to use any of the referenced products or services and make your own independent assessment (based on such advice) as to whether the referenced products or services are appropriate or suitable for you. This material may not be comprehensive or up to date and there is no undertaking as to the accuracy, timeliness, completeness or fitness for a particular purpose of information given. BNY Mellon will not be responsible for updating any information contained within this material and opinions and information contained herein are subject to change without notice. BNY Mellon assumes no direct or consequential liability for any errors in or reliance upon this material.

This material may not be distributed or used for the purpose of providing any referenced products or services or making any offers or solicitations in any jurisdiction or in any circumstances in which such products, services, offers or solicitations are unlawful or not authorized, or where there would be, by virtue of such distribution, new or additional registration requirements.

The terms of any products or services provided by BNY Mellon to a client, including without limitation any administrative, valuation, trade execution or other services shall be solely determined by the definitive agreement relating to such products or services. Any products or services provided by BNY Mellon shall not be deemed to have been provided as fiduciary or adviser except as expressly provided in such definitive agreement. BNY Mellon may enter into a foreign exchange transaction, derivative transaction or collateral arrangement as a counterparty to a client, and its rights as counterparty or secured party under the applicable transactional agreement or collateral arrangement shall take precedence over any obligation it may have as fiduciary or adviser or as service provider under any other agreement.

Pursuant to Title VII of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the applicable rules thereunder, The Bank of New York Mellon is provisionally registered as a swap dealer with the Commodity Futures Trading Commission ("CFTC") and is a swap dealer member of the National Futures Association (NFA ID 0420990).

BNY Mellon (including its broker-dealer affiliates) may have long or short positions in any currency, derivative or instrument discussed herein. BNY Mellon has included data in this material from information generally available to the public from sources believed to be reliable. Any price or other data used for illustrative purposes may not reflect actual current conditions. No representations or warranties are made, and BNY Mellon assumes no liability, as to the suitability of any products and services described herein for any particular purpose or the accuracy or completeness of any information or data contained in this material. Price and other data are subject to change at any time without notice.

Rates: neither BNY Mellon nor any other third party provider shall be liable for any errors in or delays in providing or making available the data (including rates, WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates) contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees' negligence. The WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates are provided by The World Markets Company plc ("WM") in conjunction with Reuters. WM shall not be liable for any errors in or delays in providing or making available the data contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees' negligence.

The products and services described herein may contain or include certain "forecast" statements that may reflect possible future events based on current expectations. Forecast statements are neither historical facts nor assurances of future performance. Forecast statements typically include, and are not limited to, words such as "anticipate", "believe", "estimate", "expect", "future", "intend", "likely", "may", "plan", "project", "should", "will", or other similar terminology and should NOT be relied upon as accurate indications of future performance or events. Because forecast statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. iFlow® is a registered trademark of The Bank of New York Mellon Corporation under the laws of the United States of America and other countries.

This document is intended for private circulation. Persons accessing, or reading, this material are required to inform themselves about and to observe any restrictions that apply to the distribution of this information in their jurisdiction.

Currency Administration is provided under and subject to the terms of a definitive agreement between BNY Mellon and the client. BNY Mellon exercises no investment discretion thereunder, but acts solely pursuant to the instructions in such agreement or otherwise provided by the client. Unless provided by definitive agreement, BNY Mellon is not an agent or fiduciary thereunder, and acts solely as principal in connection with related foreign exchange transactions.

All references to dollars are in US dollars unless specified otherwise.

This material may not be reproduced or disseminated in any form without the prior written permission of BNY Mellon. Trademarks, logos and other intellectual property marks belong to their respective owners.

The Bank of New York Mellon, member FDIC.

© 2020 The Bank of New York Mellon Corporation. All rights reserved.