BNY MELLON

iFlow
SHORT THOUGHTS

February 13, 2024

Drawdown Of Fed's RRP Takes A Breather

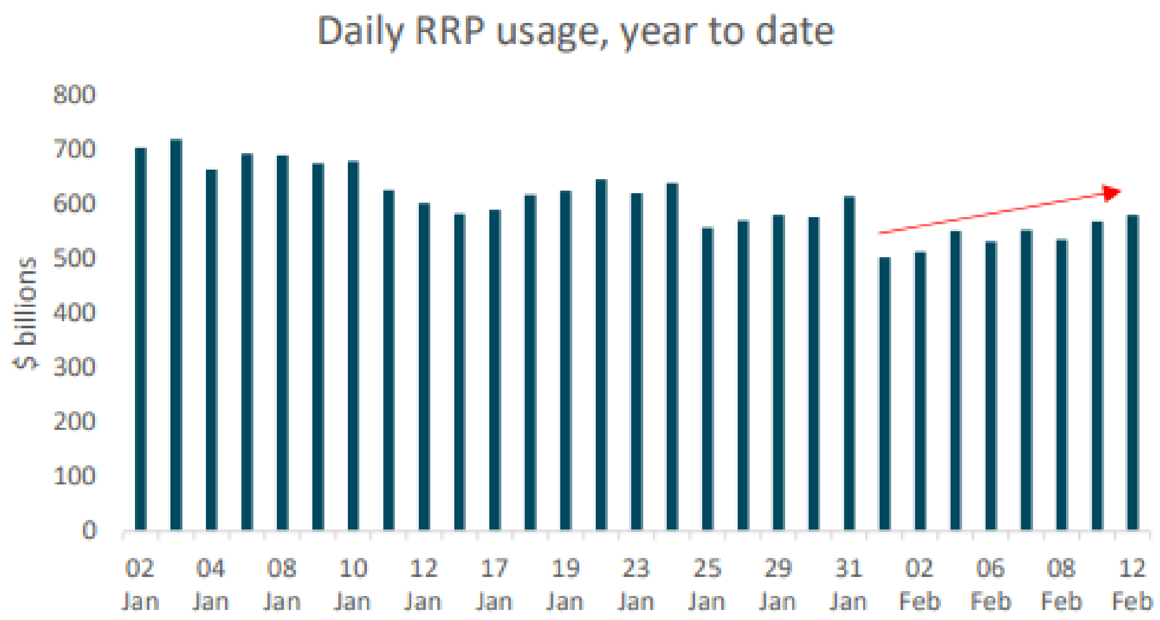
TGA Balances High, Bill Issuance Relenting

- RRP take-up has begun to stabilize, actually increase slightly
- MMF assets almost equal to T-bills in circulation
- iFlow shows real money exiting cash, buying bills - will it last?

A Pause in RRP drawdown

As is well known, daily balances in the Federal Reserve's overnight reverse repurchase (RRP) facility have been declining from over $2 trillion at the end of May last year. The steady and almost inexorable decline has occurred amid increased T-bill issuance and higher short-term rates that have made parking cash every day at the Fed, where it currently earns 5.3%, less attractive than alternatives. So far in February, however, RRP usage has stopped declining and has even been slightly rising. On Feb. 1, RRP take-up was $503bn, the lowest level since the drainage of the facility began in earnest last June. On Feb. 12, take-up was $581bn, the highest usage all month (chart below). Is the RRP drain over? Are money market mutual funds (MMF) done taking cash out of RRP and deploying it into bills?

RRP Balances Tick Up So Far In February



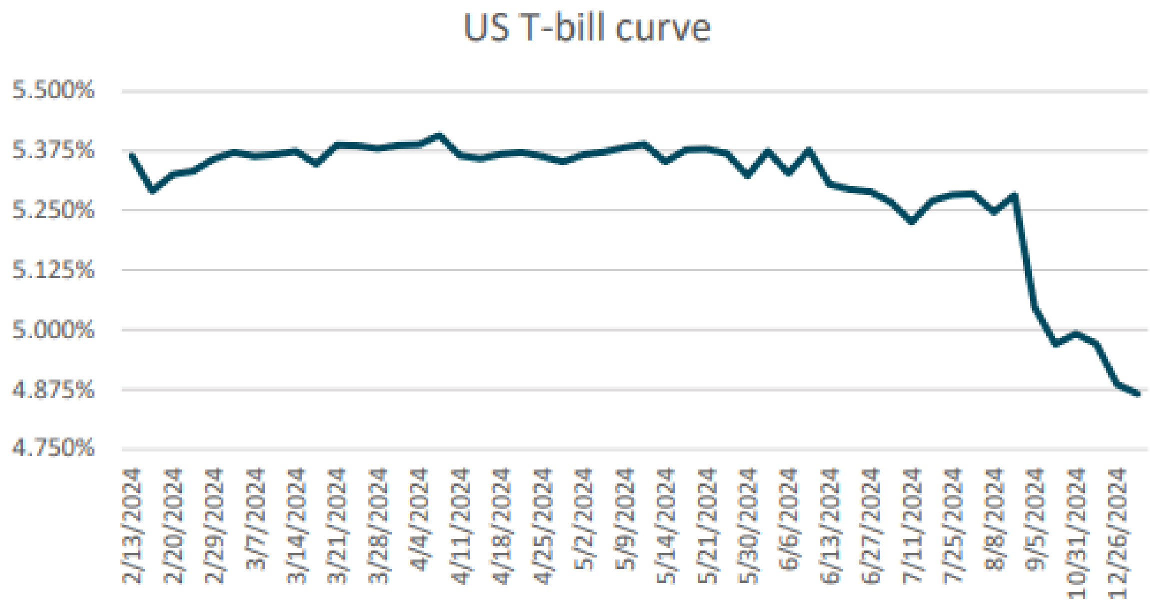
Source: BNY Mellon, Federal Reserve Bank of New York, Bloomberg

---

A few weeks ago, we argued that lower yields on T-bills beyond June maturities might induce some slowing in the trade that MMFs have been running for the last six or seven months. In brief, MMF assets rise, hitting a new record seemingly every week. That influx of cash doesn't get converted into RRP balances anymore, but instead goes into the fresh bill supply, where these short-term obligations generally earn well above the 5.3% RRP rate.

However, as rate cuts loom, T-bills maturing after June and further out the curve have been yielding substantially less. Extending duration for these MMFs is beginning to look less attractive. Granted, if and when rate cuts begin, the rate paid on RRP balances will also fall, perhaps keeping those longer-maturity bills attractive at such time. The chart below shows the T-bill yield curve out to December, and we can clearly see the kink lower in returns after mid-June this year, declining as we go ever longer in maturity.

Not-So-Attractive Bill Yields After June

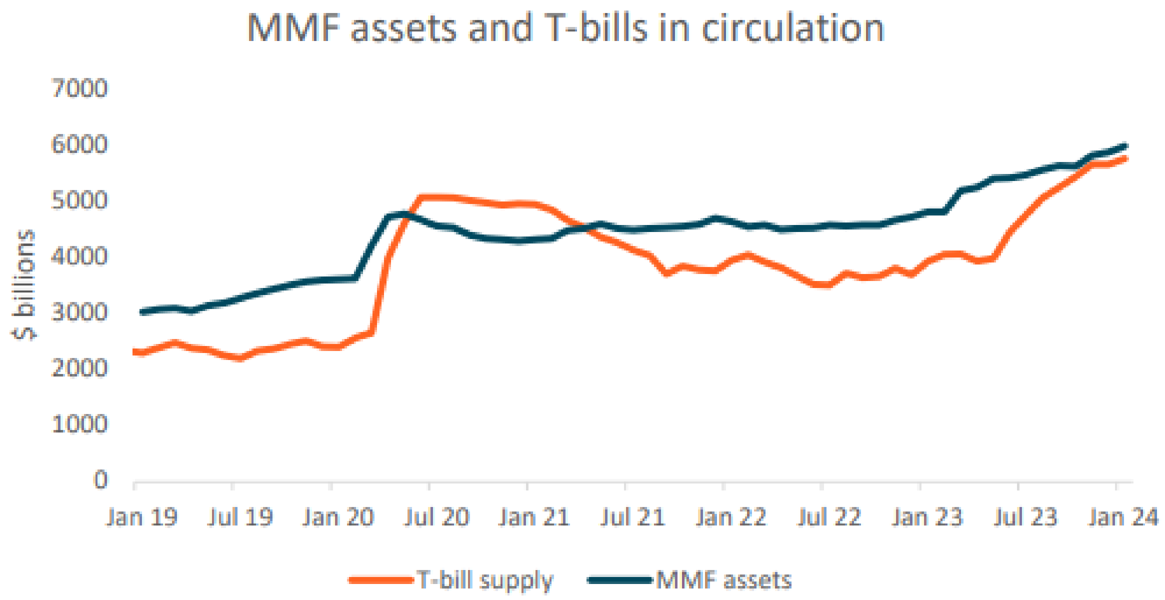


Source: BNY Mellon Markets, Bloomberg

Furthermore, the Treasury is likely to issue relative fewer bills given the quite-flush balances in the Treasury General Account (TGA), which currently stand at $831bn – well above the $750bn which had been signaled by Treasury. Furthermore, tax revenues are expected to be higher this filing season than last year.

If for these reasons and others bill issuance does slow, it’s not clear to us that MMFs will have the same appetite for progressively more expensive issues and fewer of them. The chart below shows that the gross quantities of both MMF assets and bills in circulation are nearly equal now. This suggests that the market is close to being in balance – and that any relative slowing in bill supply could slow the impressive RRP drainage since last June. Increasing repo market volumes and declining repo interest rates suggest that there is a viable alternative for MMFs to lend cash than just to the RRP desk.

MMF AUM & T-bill Supply Roughly Equal

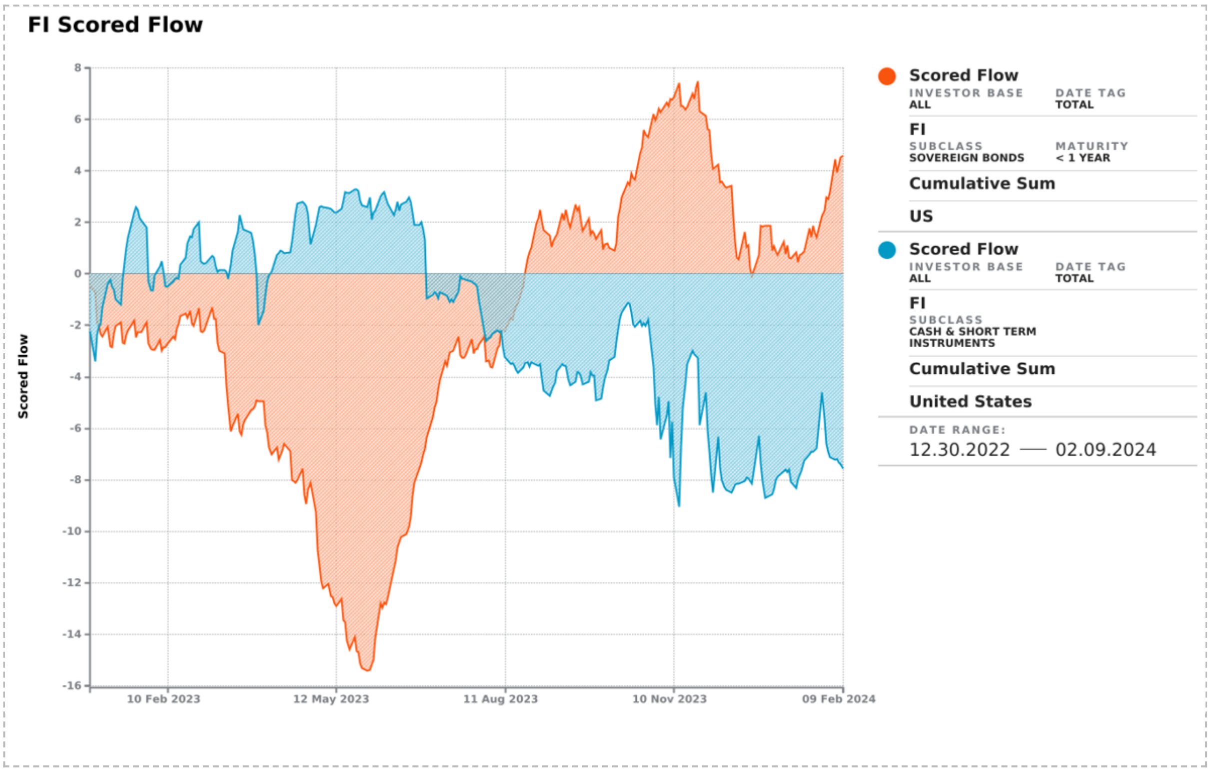


Source: BNY Mellon Markets, ICI, SIFMA, Bloomberg

Our iFlow data shows a similar dynamic. In the chart below, we plot real money demand for Treasuries sub-1y in maturity (a proxy for T-bills, but including other sovereign bonds with less than 1y remaining until maturity) against that for Cash and Other Short-Term assets (CAST). While not perfect, there is generally an inverse relationship between sub-1y maturity flows and CAST flows. We can see demand for bills skyrocketed in the middle of 2023 while cash and cash-like flows turned negative around the same time.

Bill demand in H2 2023 had its ups and downs, literally. The retreat from CAST has been steadier, though it too fluctuated. It's interesting to see a reprise in short-term Treasury issues at the start of this month, and a nearly coincident pullback in demand for CAST. We see this indicative of real money demand for short-maturity paper at the expense of CAST.

Swapping Cash For Bills?



Source: BNY Mellon Markets, iFlow

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

John Velis
AMERICAS MACRO STRATEGIST

CONTACT JOHN

bnymellon.com