

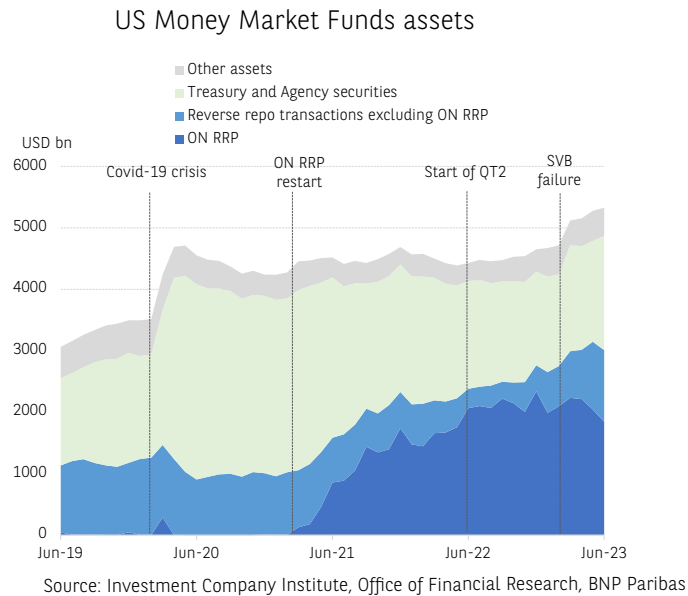
CHART OF THE WEEK



19 July 2023

UNITED STATES: MONEY MARKET FUNDS REALLOCATE THEIR ASSETS OUTSIDE THE ON RRP FACILITY

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On average, over the past year, US money market funds (MMFs) have “deposited” almost USD 2,200bn in cash with the Federal Reserve (Fed) every day in exchange for the overnight reverse repurchase of Treasury securities held on the Fed’s balance sheet (Overnight Reverse Repo Facility, ON RRP). In recent months, these “deposits” have fallen sharply. On 17 July, they stood at «only» USD 1,730 bn.

In March 2020, the Covid-19 shock had triggered a major influx of resources to the MMFs, which had largely invested them in short-term Treasury securities (T-bills). In 2021, the drying up of the supply of good-quality short-term paper (T-bills, Federal Home Loan Bank [FHLB] debt securities) prevented funds from renewing their portfolios and threatened to result in an excessive supply of liquidity on the repo and FX swap markets. By reactivating the ON RRP facility, the Fed was able to establish a floor for short-term market rates, encouraging MMFs to «lend» it part of their cash rather than lending it on the repo markets, where demand had dried up considerably.

However, the tightening of monetary policy that began last year destroyed some of the excess liquidity created in 2020. The resulting increase in demand for financing pushed up repo rates and reduced the relative attractiveness of the ON RRP facility. As a result, MMFs significantly increased their repo loans to banks (+USD 890 bn between September 2022 and June 2023), notably through the Fixed Income Clearing Corporation. They also reinvested in FHLB debt securities (+USD 250 bn), whose loans to banks (advances) reached a record level at the end of March, and in T-bills (+USD 330 bn in June alone). The political compromise on the US debt ceiling, reached in early June, will enable the Treasury to issue large volumes of T-bills for several months. MMFs’ appetite for these bills would be welcome. Otherwise, primary dealers’ inventories are likely to grow even larger and their ability to intermediate the Treasuries markets will deteriorate.

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