The Bank Treasury Newsletter
The Chart Deck
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In This Month’s Chart Deck

- Following up on the themes in this month's newsletter, the first set of slides illustrates some conflicting trends related to interest rates and the outlook for cuts by the Fed before the end of the year. For example, even though Fed officials seem to be backing away from initiating cuts before the summer, they are still institutionally committed to cutting the Fed funds rate because they view it as restrictive. Their views are guided in part by the theoretical interest rate called R-Star, which is an equilibrium risk-free, overnight rate, which is not expansionary or restrictive assuming that the economy is at full employment, and which, as shown in Slide 4, remains relatively unchanged since the Global Financial Crisis when the Fed brought rates down to the 0 lower-bound. Nevertheless, the market continues to fade rate cuts in 2024 based on what the forwards and Fed fund futures indicate (Slide 5). As the inverted yield curve reverts and 10-year Treasury yields climb above 4.6%, the fair value unrealized loss in bank investment portfolios is unlikely to recover soon (Slide 6).

- Last month, the Fed ended its special liquidity facility, the Bank Term Funding Program (BTFP), which peaked at over $160 billion. Since it was closed, the facility's balance, which consists of one-year loans that banks could use to fund their bond portfolios at their par value at what was then a generous rate, is already down by $30 billion (Slide 7). Sitting on the asset side of the Fed's balance sheet, the falling BTFP also reduces bank reserve deposits on the liability side of its balance sheet. However, as Slide 8 traces, the Fed is also working down the balance of its Reverse Repo Facility (RRP), which, because it sits on the liability side of its balance sheet, counteracts the effects of Quantitative Tightening (QT) and the falling balance of the BTFP, and was the primary reason why bank reserve deposits at the Fed have been increasing (Slide 9).

- Squeezed out of the RRP, Money Market Fund assets, heading towards $7 trillion (Slide 10), have returned to bank deposits (Slide 11). Meanwhile, with loan demand slacking, given the uncertainty about the economy and the timing of rate cuts, banks in the Fed’s large bank peer group used in its H.8 report have deployed their excess deposits to increase the balance of their investment portfolios, primarily in Treasurys (Slide 12). However, banks also reported this month that they had begun to buy mortgage-backed securities (MBS).

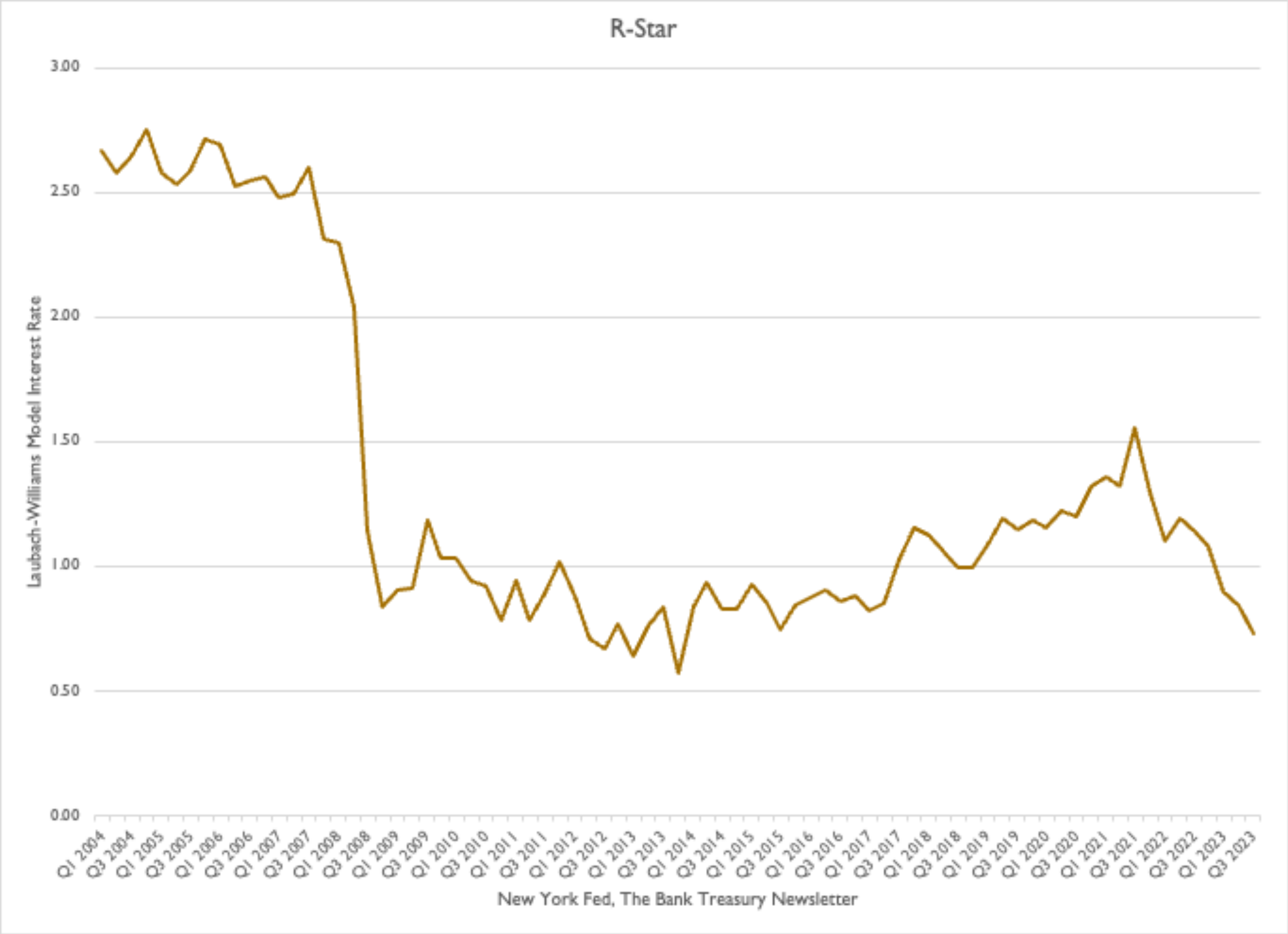
- Earning roughly $45 billion a quarter on its System Open Market Account (SOMA) and its other interest-earning assets (based on its Q3 2023 statement), the Fed is paying out $73 billion to banks, money market funds, and other central banks in interest expense for reserve deposits and the RRP. The deficit is accumulating as an IOU to the U.S. Treasury (Slide 13) on the liability side of its balance sheet and equaled over $160 billion this month, which also adds to bank reserve deposits.

List of Slides

- R-Star, Laubach-Williams Model, *Sources: New York Fed, The Bank Treasury Newsletter*
- 30-Day Fed Funds Futures, September 2024 Expiration, *Sources: Barchart.com, The Bank Treasury Newsletter*
- Unrealized FV Loss In Total Securities (AFS + HTM), December 2023, *Sources: Call Reports, FIS FedFis LLC., The Bank Treasury Newsletter*
- Bank Term Funding Program, *Sources: H.4 Report, Federal Reserve, The Bank Treasury Newsletter*
- Reverse Repo Facility, *Sources: H.4 Report, Federal Reserve, The Bank Treasury Newsletter*
- Reserve Deposits, *Sources: H.4 Report, Federal Reserve, The Bank Treasury Newsletter*
- Money Market Fund Assets, *Sources: Money Market Fund Monitor, Office of Financial Research, The Bank Treasury Newsletter*
- Bank Deposits, *Sources: H.8 Report, Federal Reserve, The Bank Treasury Newsletter*
- Treasury and Agency MBS Held By Large Banks, *Sources: H.8 Report, Federal Reserve, The Bank Treasury Newsletter*
- Cumulative Negative Treasury Remittances, *Sources: H.4 Report, Federal Reserve, The Bank Treasury Newsletter*

Neutral Rates Are Down Not Up

Fed economists generally believe that the present level of short-term rates is restrictive based on interest rate benchmarks such as R-Star.



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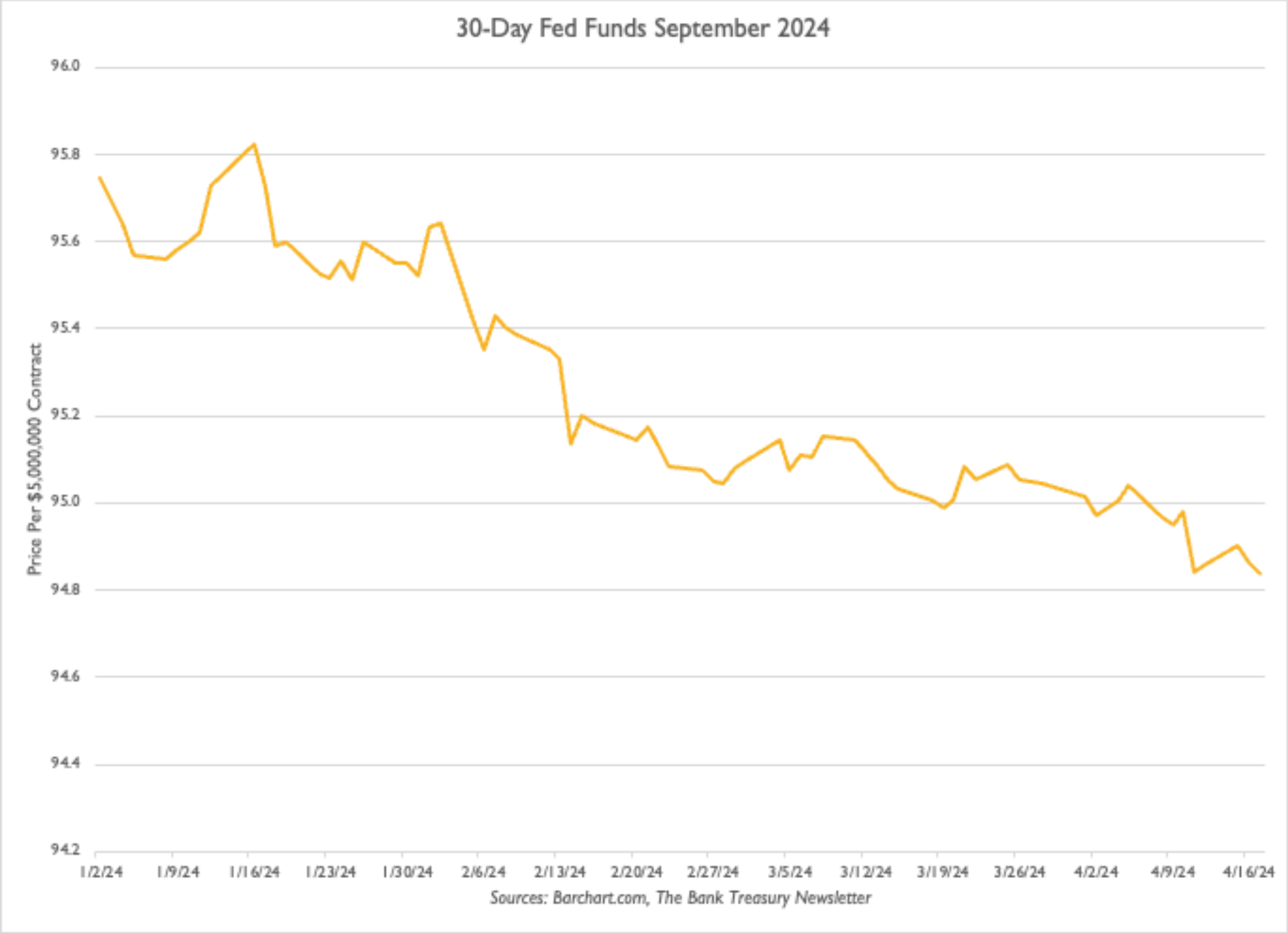
Rate Cut Optimism For 2024 Fades

Bank treasurers expect fewer or no rate cuts in 2024 than they expected even last month, as the market, like the Fed, remains data-dependent.



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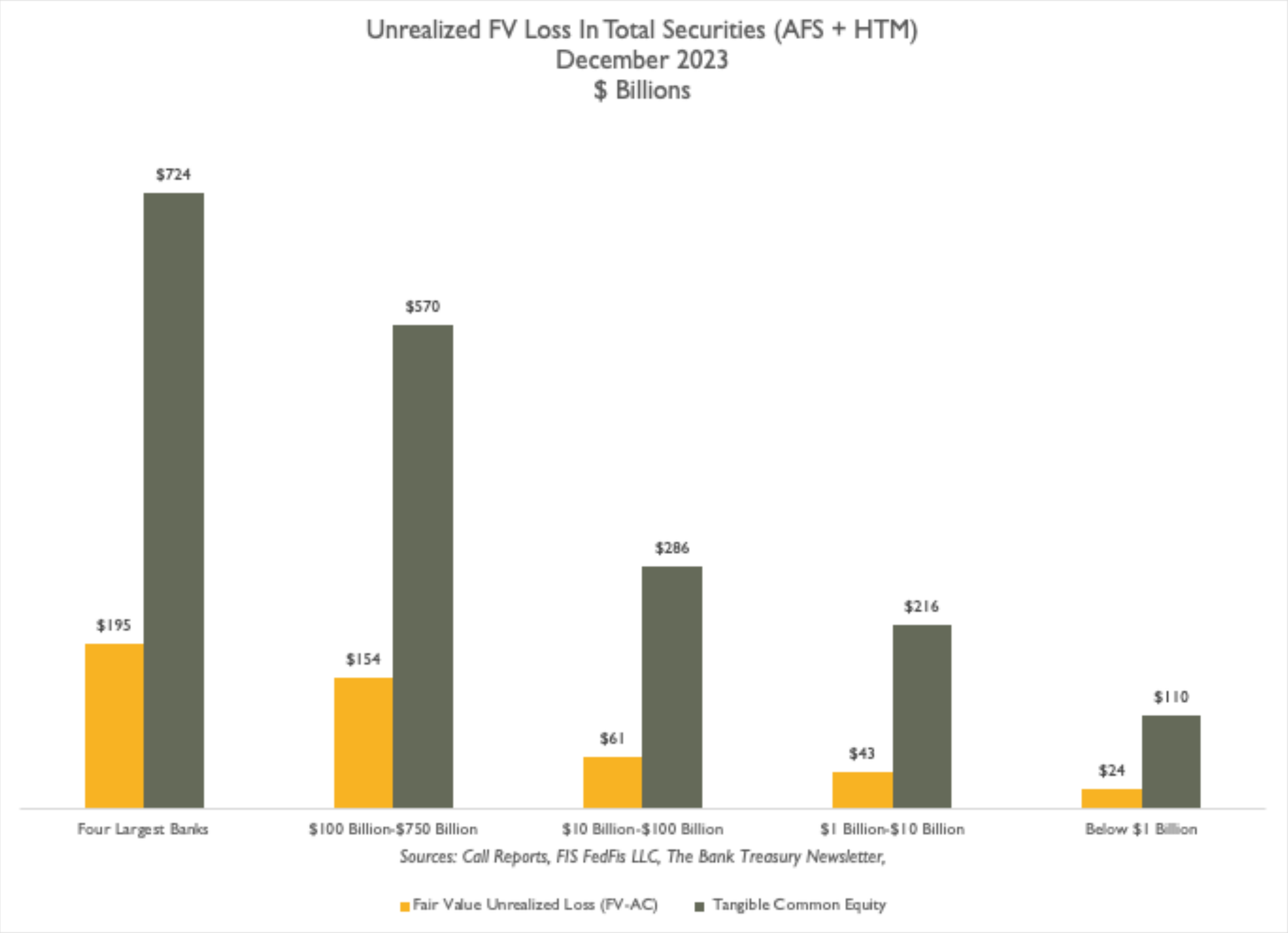
Sizeable Unrealized FV Losses Not Going Away

The fair value unrealized loss on investment portfolios, including held-to-maturity (HTM) and available-for-sale (AFS), equaled about 20% of tangible common equity for banks across the size spectrum.



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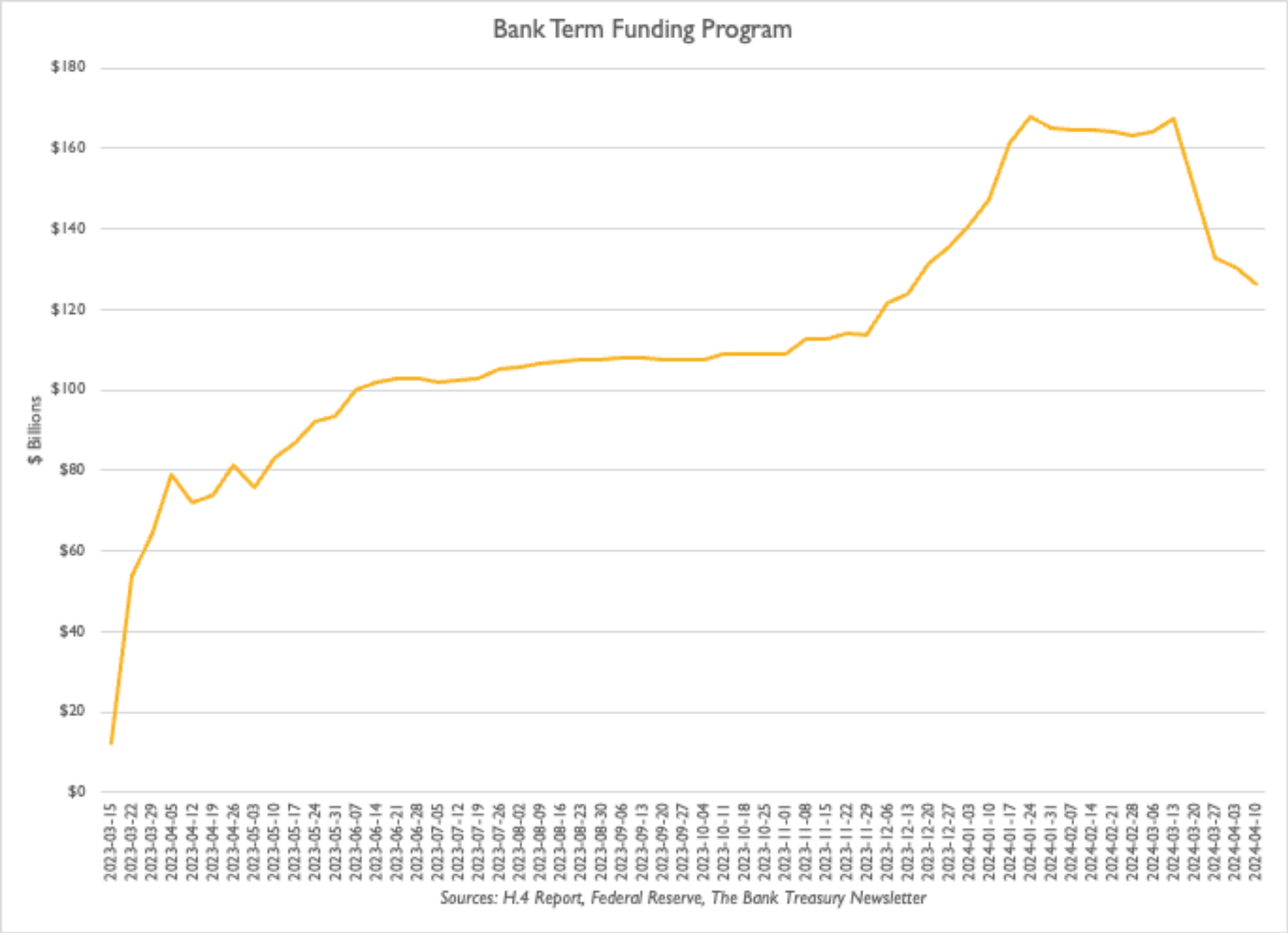
BTFP Run-Off Begins

The program, which officially ended last month on March 11th, was run out of the Fed's discount window but offered terms that were considerably more generous than terms for primary credit, including valuing the collateral at par and charging a rate equal to 10 basis points over the overnight index swap benchmark rate.



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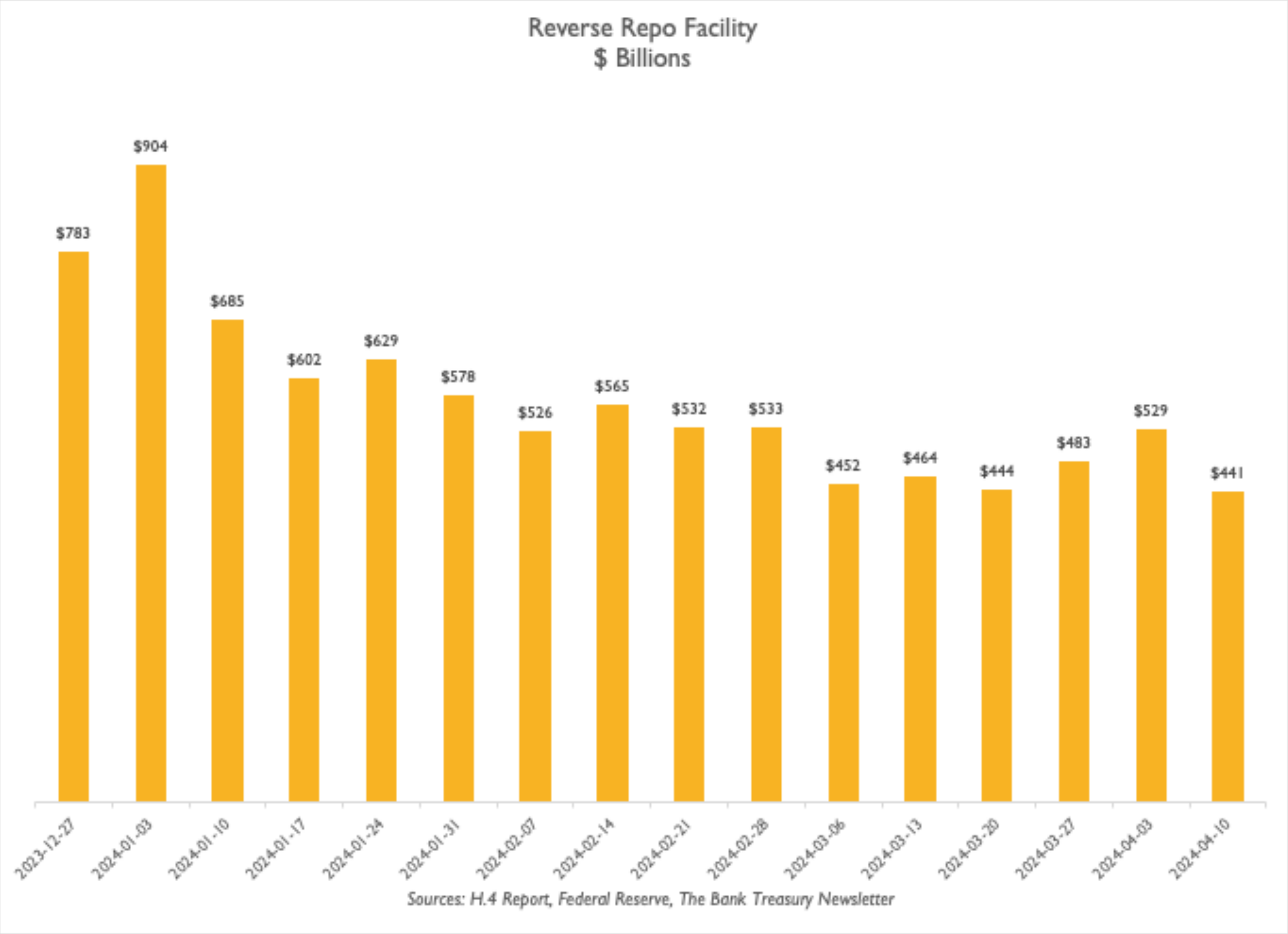
Fed Is Turning Away MMF Repo Money

The facility, which peaked at over $2.4 trillion last summer, not only counteracted the negative effect of QT and the replenishment of the Treasury General Account on bank reserve deposits but also added to the reserve balance, which stood at $3.6 trillion this month.



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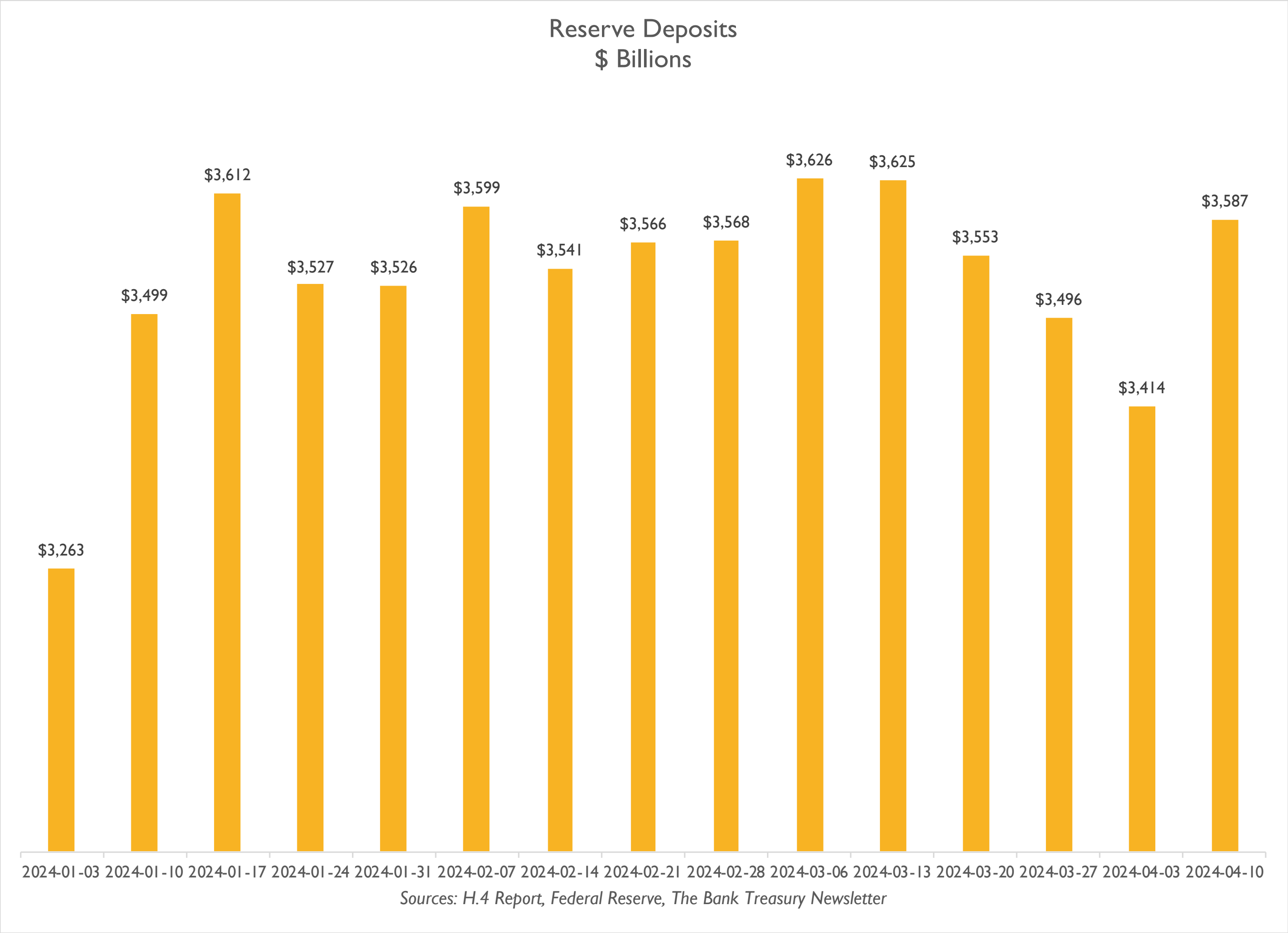
Reserves Increase Despite QT

Since the Fed began QT in June 2022, the balance of SOMA fell by $1.6 trillion and stands at $6.9 trillion this month. Reserve deposits equaled $3.5 trillion this month, $0.2 trillion higher than the balance when QT began.



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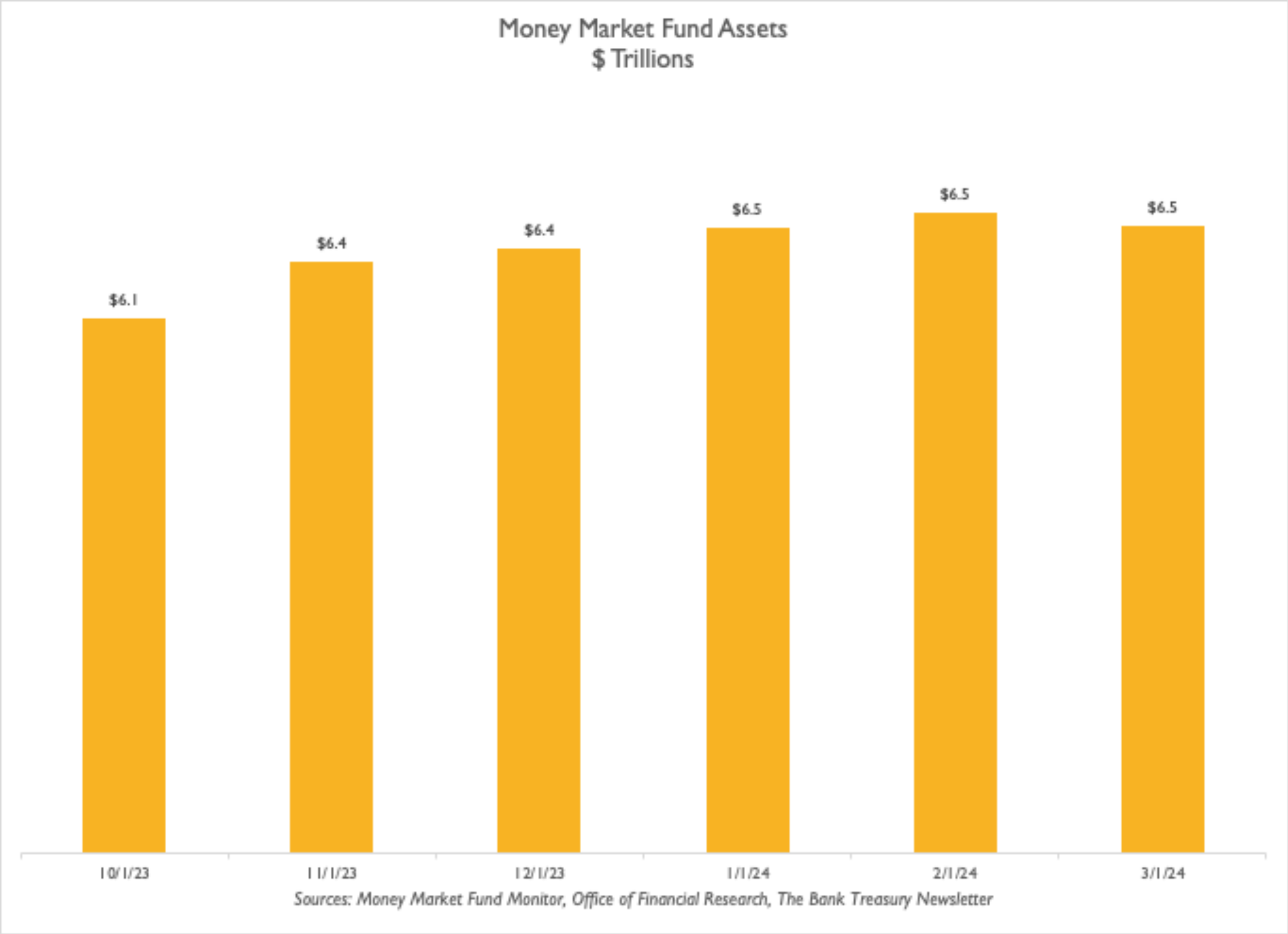
Money Market Fund Assets March Higher

Retail money is driving the growth in fund assets, with retail funds increasing by $0.4 trillion in the last year to over $1.7 trillion.



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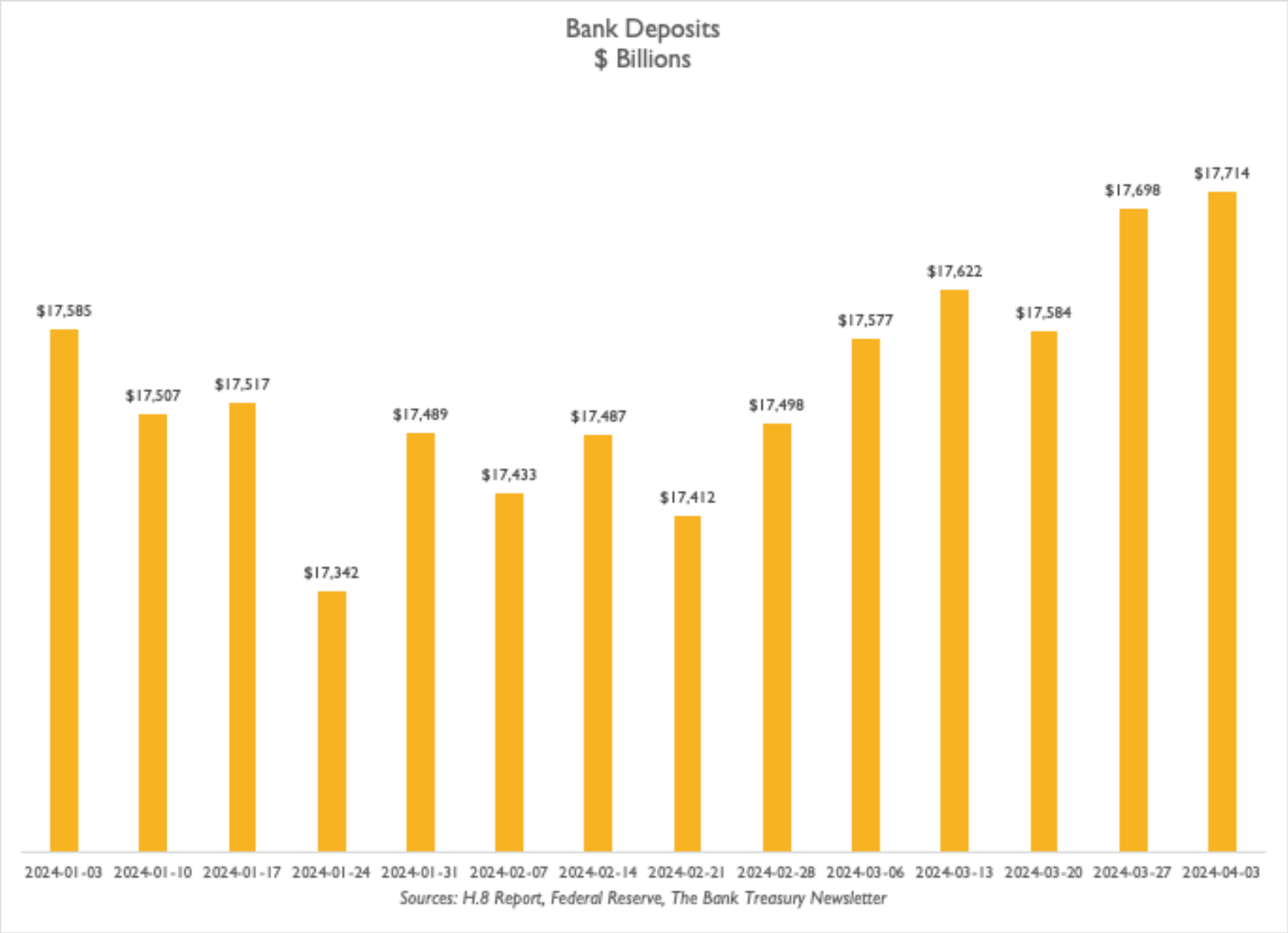
MMFs Shifted Back Into Deposits



Without room in the Fed's shrinking RRP for their cash inflows, the funds helped drive bank deposits higher over the last six months.

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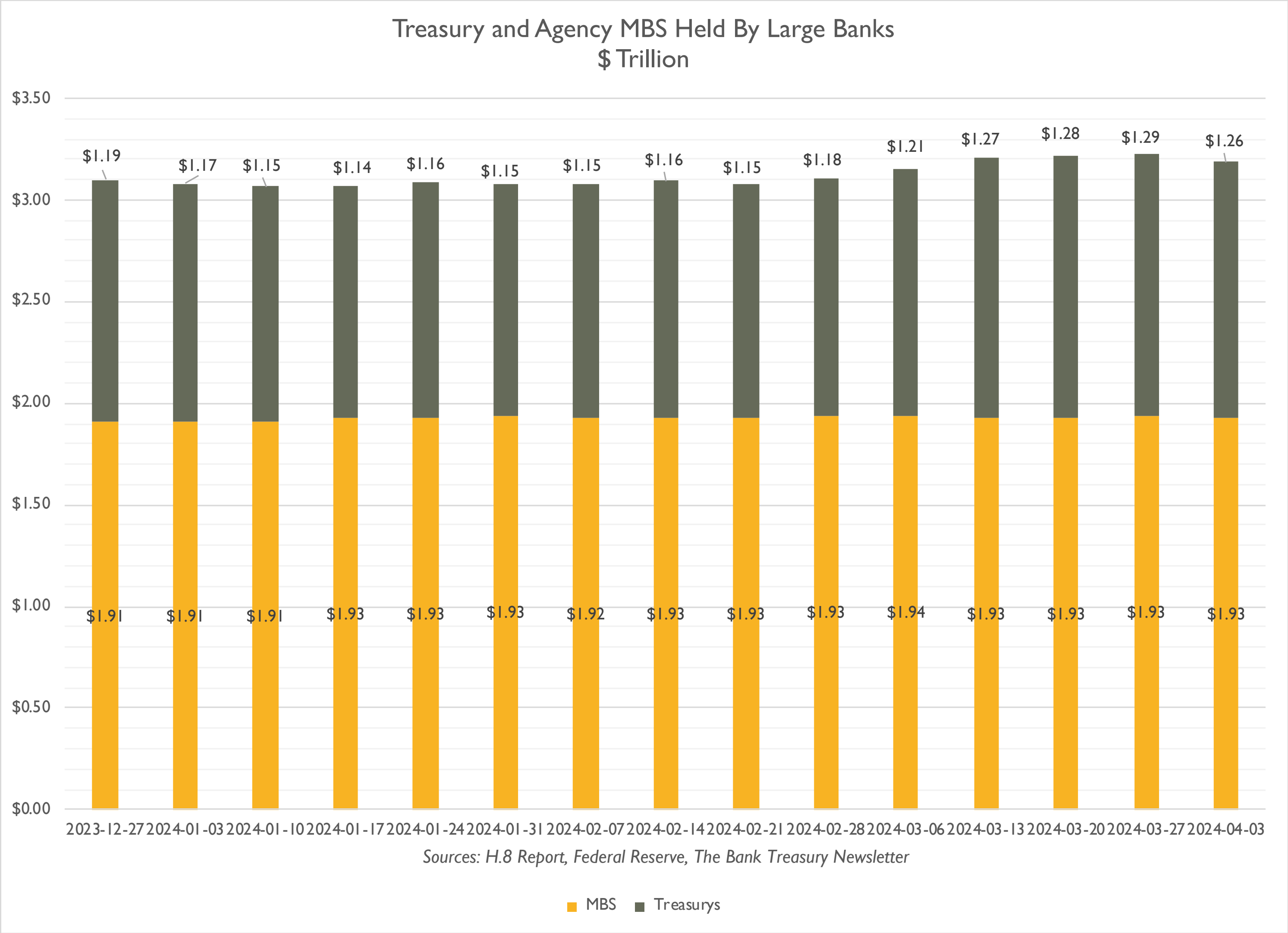
Large Banks Added Treasury Securities



Without enough loan demand to absorb the increase in bank deposits, large banks increased their investment in Treasury securities.

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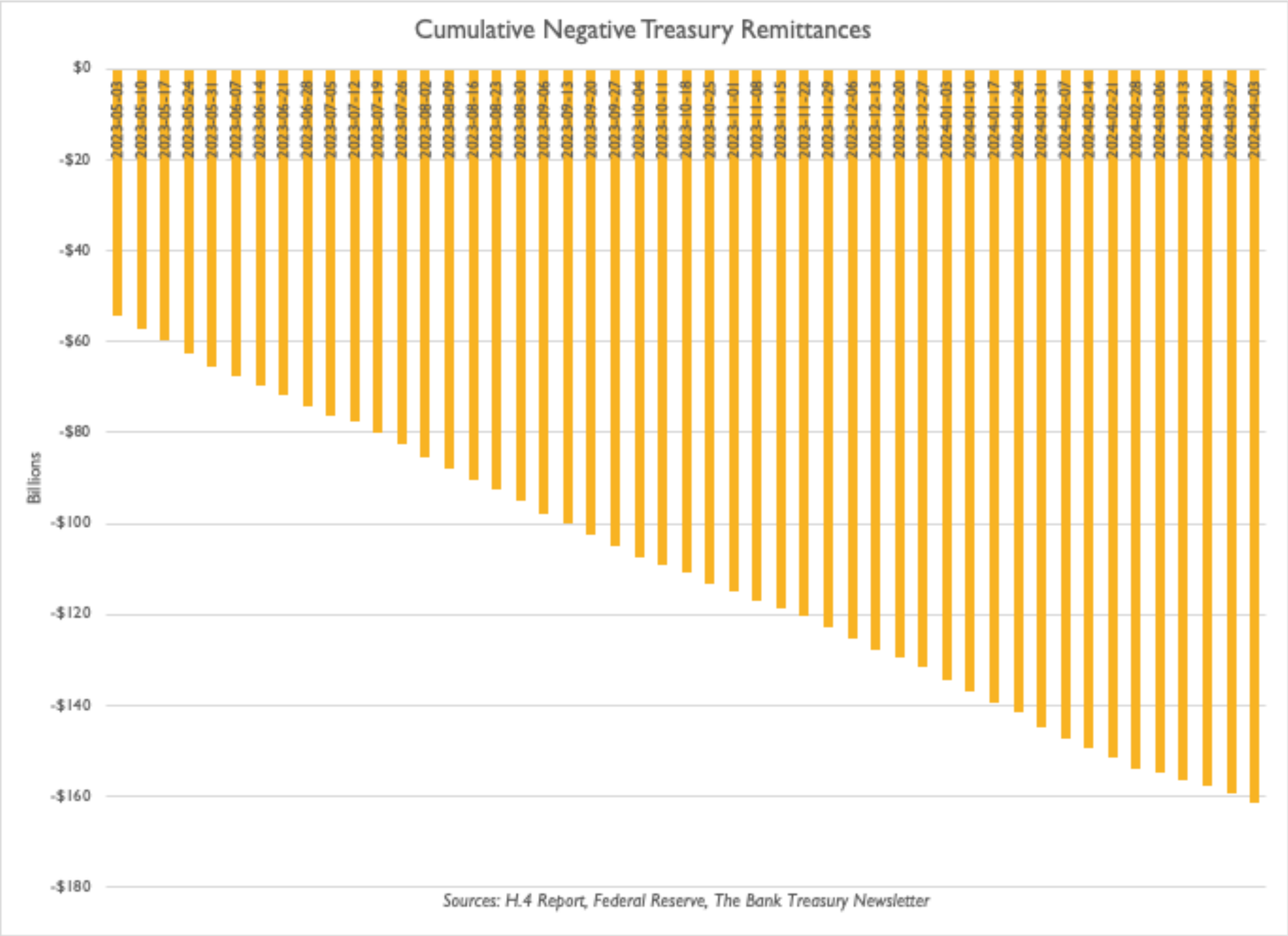
Fed's IOU To The Treasury Grows And Grows



The BTFP, the RRP, and negative treasury remittances added $0.4 trillion to bank reserves since the beginning of the year. Of this amount, $0.3 trillion offset the decline in the balance of SOMA from $7.2 trillion to $6.9 trillion. The rest went to increase reserves and balance a slight increase in currency in circulation.

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