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

- As far as bank treasurers are concerned, the FDIC might as well seize their bank if they find themselves forced to borrow from the Fed's discount window, never mind what the Fed and the FDIC want or say. There were only three instances when the industry came in big to borrow from the Fed's discount window in the last 20 years. They were the Global Financial Crisis (GFC) in 2008, the Covid shutdown in March 2020, and the financial panic last March. In all three cases, the Fed saw a surge in primary credit that was quickly repaid. But generally, the industry believes that borrowing from the window risks market stigma that could be fatal and thus, discount window borrowing is rare. If a bank does find itself forced to go to the window for a loan, it usually pays it down quickly, if it survives to be able to repay it. (See this month's newsletter for more discussion on the pros and cons (mostly cons) of using the discount window for emergency funding.) Bank treasurers are still wary of using the Bank Term Funding Program (BTFP), which the Fed runs from the discount window, and which it created to address the market panic after SVB, for the same reason. But the Fed has generally succeeded in coaxing banks to borrow funds from the BTFP and keep them outstanding, as the account balance continues to edge higher even after the financial stresses from last spring have eased (Slide 4).
- The BTFP, which is on the asset side of the Fed's balance sheet, supplies reserves to the banking system. Reserves are also created by negative Treasury remittances (Slide 5), which is the difference between the sum of what the Fed pays banks for Interest On Reserve Balances (IORB) and pays money market funds in the overnight Reverse Repo Facility (RRP), and what it earns in interest receivables on its System Open Market Account, primary credit, the BTFP, and its other interest-earning assets. The Fed remits its net income to the Treasury every week, but since the beginning of 2023 it ceased these remissions because it is earning less than it is paying out to the banks and the money market funds. Instead, it began accumulating a deferred asset, which it will need to realize in future earnings before it can resume remittances. While the increase in the BTFP and the increasing cumulative negative remittances add reserves to the system, they only offset a fraction of the reserves that are drained by Quantitative Tightening (QT), as the SOMA portfolio runs off subject to monthly caps, $60 billion for Treasurys and $35 billion for Agency MBS. Growth in currency in circulation, the RRP (Slide 6), and the Treasury General Account (TGA) (Slide 7), which all sit on the liability side of the Fed's balance sheet, reduce reserves when their balances increase and increase reserves when their balances fall. Thus, over the last six months, reserves increased by $0.4 trillion, to $3.5 trillion. This was driven by a $1.5 trillion reduction in the RRP (a liability), a $0.1 trillion increase in the BTFP (an asset), and a $0.1 trillion increase in negative remittances (a liability), offset by a $0.7 trillion increase in the TGA (a liability) and a $0.8 trillion decline in SOMA. Currency in circulation, after soaring steadily since 2008 through 2022, from $0.8 trillion to $2.3 trillion, which grew at an average annual 9% rate from 2020-22, was flat during 2023.
- M2 has been flat since last spring and, at just under $21 trillion, is still $6 trillion higher than where it stood before March 2020 (Slide 8). But money supply's connection to consumer spending is getting increasingly tenuous, as consumer preferences increasingly have been souring on cash as a payment method in favor of credit cards according to a 2023 study of payments by the Fed. Even payment apps, heralded as becoming a significant payment channel during Covid, have not had the success that had been envisioned compared to cards (Slide 9). Meanwhile, consumer spending habits and higher rates have driven the mix of noninterest-bearing deposits to total deposits for the system back down to its pre-Covid level, at 22% (Slide 10) which adds to pressure on bank deposit funding costs and net interest margins.
- While bank treasurers have been adjusting their asset-liability management models for shorter, less stable deposit funding, the industry's investment in illiquid earning assets, such as the held-to-maturity (HTM) account (Slide 11) is at a 25-year high, and its reliance on uninsured deposits (Slide 12) to fund these assets has also never been higher. When the loan-to-deposit ratio, a broad measure of balance sheet liquidity, is adjusted to include the HTM portfolio (Slide 13), the result indicates that balance sheet liquidity is back to the level it stood on the eve of Covid.

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- Primary Credit and the BTFP: Weekly Average, *Sources: H.4 Report, Federal Reserve, The Bank Treasury Newsletter*
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- Major Right-Side Components of the Fed's Balance Sheet, *Sources: H4 Report, Federal Reserve, The Bank Treasury Newsletter*
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- Consumer Payment Methods, *Sources: FRB Services, Federal Reserve, The Bank Treasury Newsletter*
- Noninterest Bearing Deposits % Total Deposits, *Sources: FRED, St. Louis Fed, The Bank Treasury Newsletter*
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- Loans + HTM Securities % Total Deposits, *Sources: Quarterly Banking Profile, FDIC, The Bank Treasury Newsletter*

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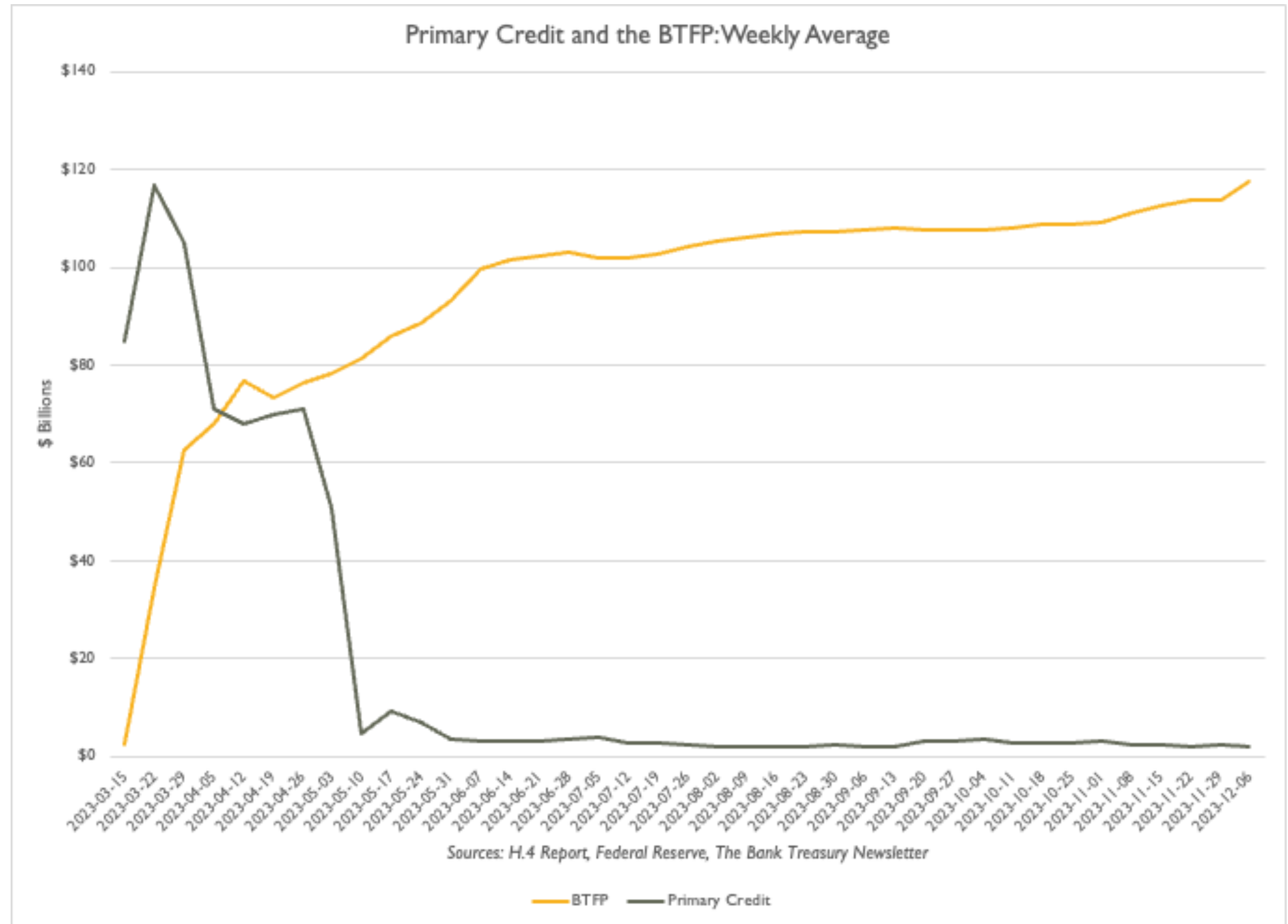
BTFP Replaces Primary Credit

Bank treasurers seem to be warming to the benefits of using the BTFP to supplement some of their funding needs.



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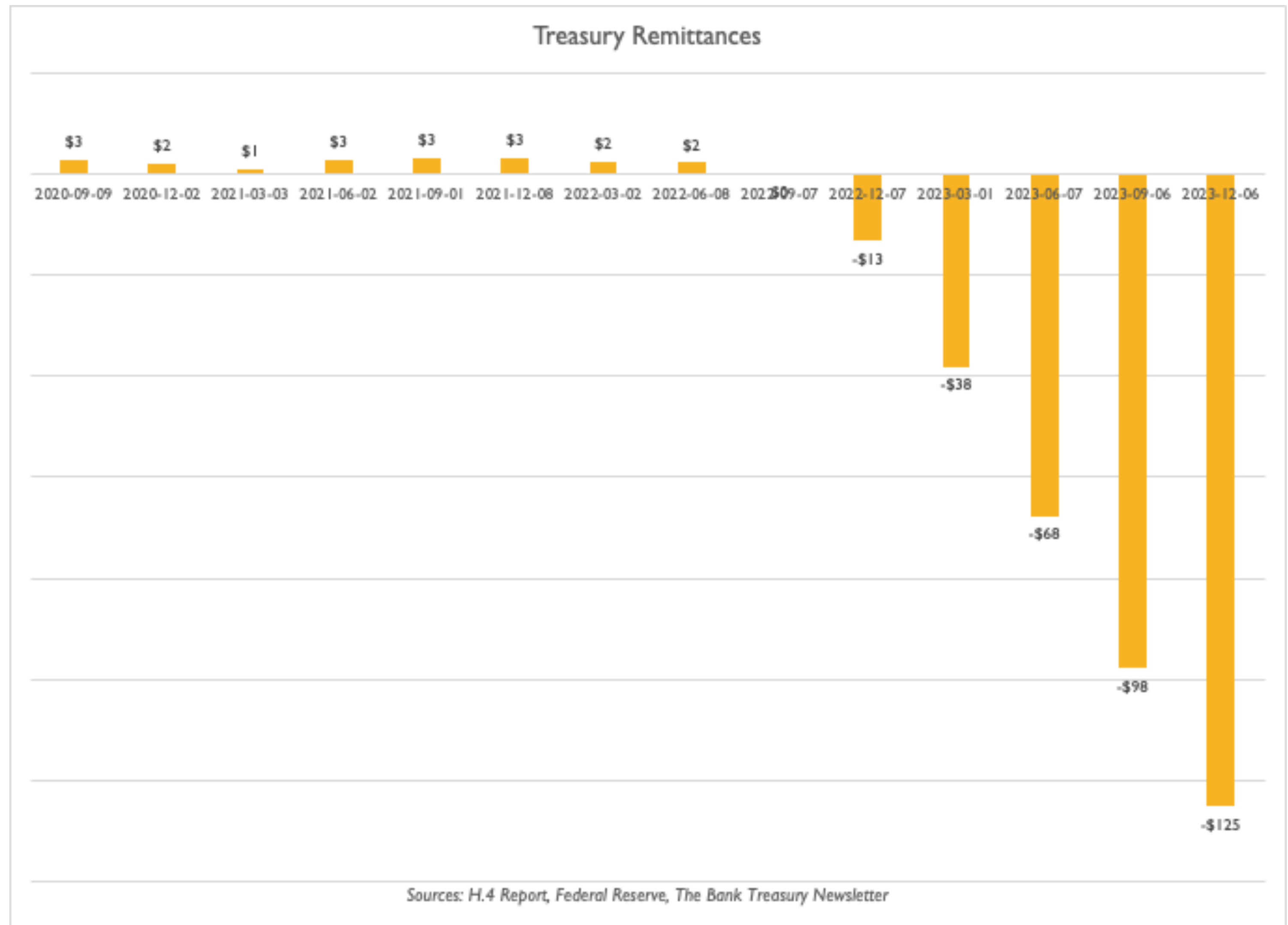
Fed's Balance Sheet In The Red

While the BTFP increased to over $120 billion on the left side of the Fed's balance sheet this month, the increase was nearly balanced by cumulative negative remittances to the Treasury that reached $125 billion on the right side of the Fed's balance sheet.



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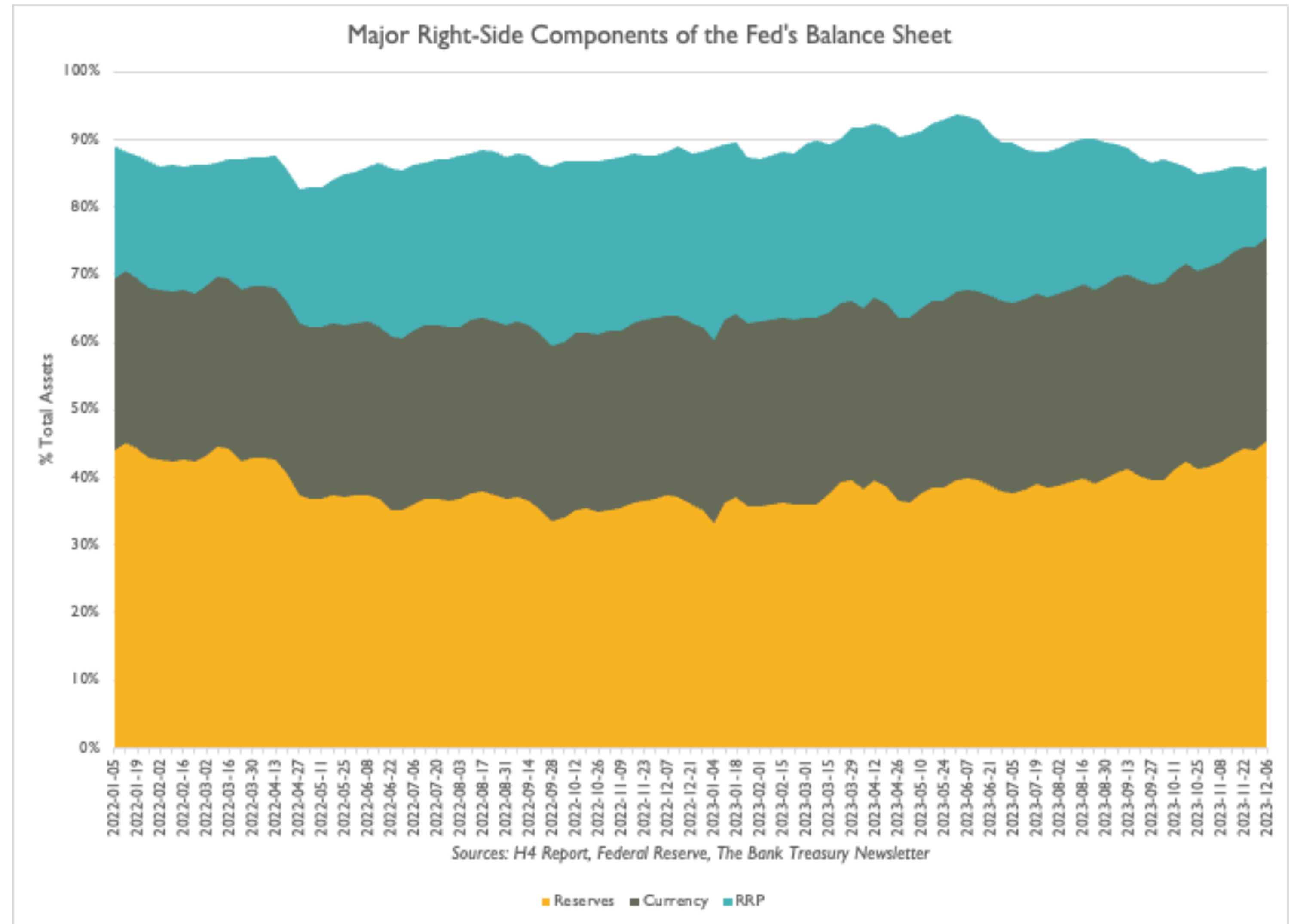
Fed's Liability Mix Shifted In H2 2023

The RRP fell by $1.5 trillion since last May, which essentially funded a $0.4 trillion increase in reserves. Currency in circulation, at $2.3 trillion, the second largest liability on the Fed's balance sheet, grew by just 0.3% in 2023. The modest growth this year contrasts to previous years since Covid began when it grew at an average annual rate of more than 9% through December 2022.



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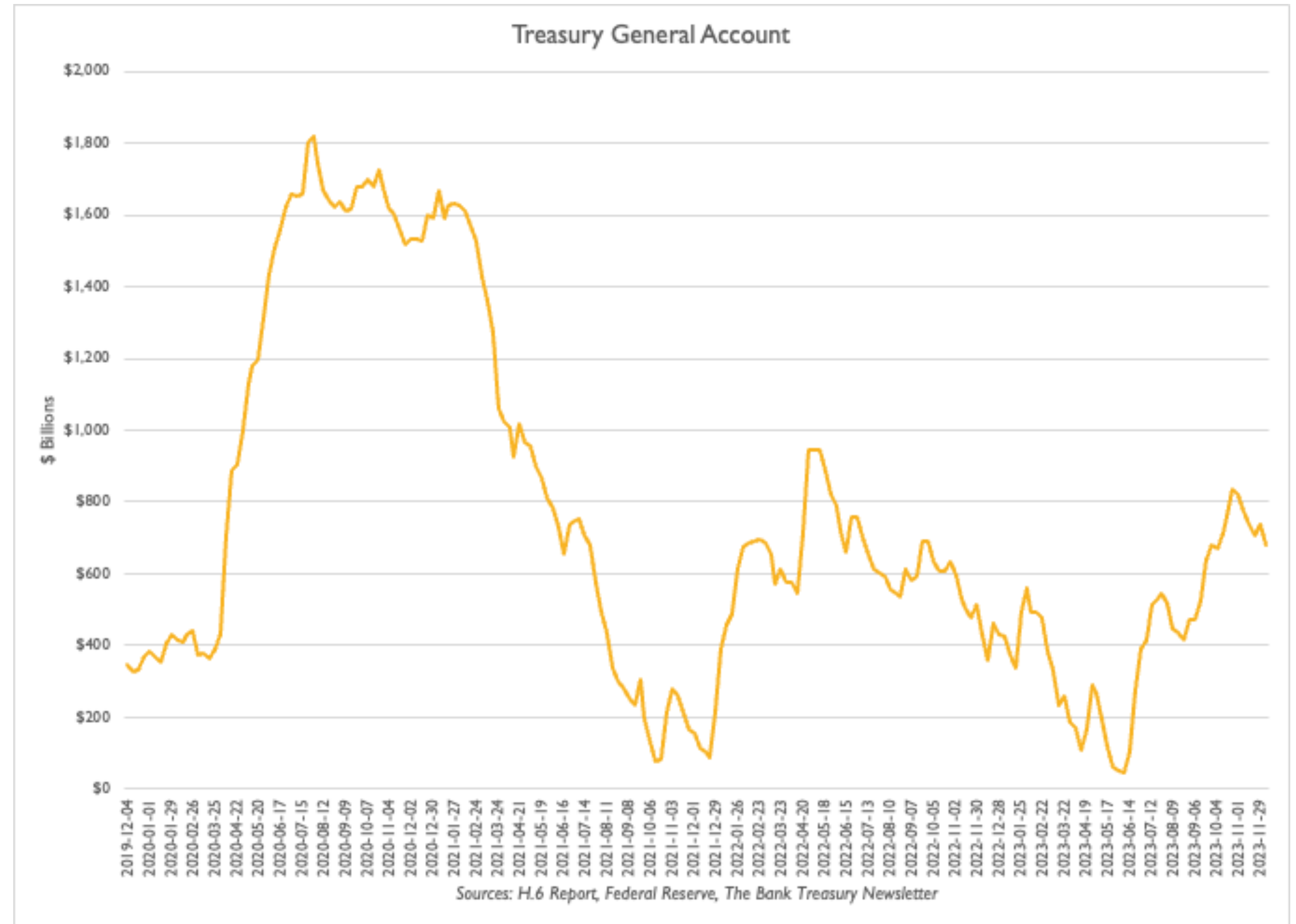
Treasury Bolsters Its TGA Account

At nearly $0.7 trillion, the TGA is substantially recovered from where it stood near $0 at the time of the Federal debt ceiling extension agreed last June. However, the balance is nowhere near where it stood in the early days after the passage of the Covid stimulus.



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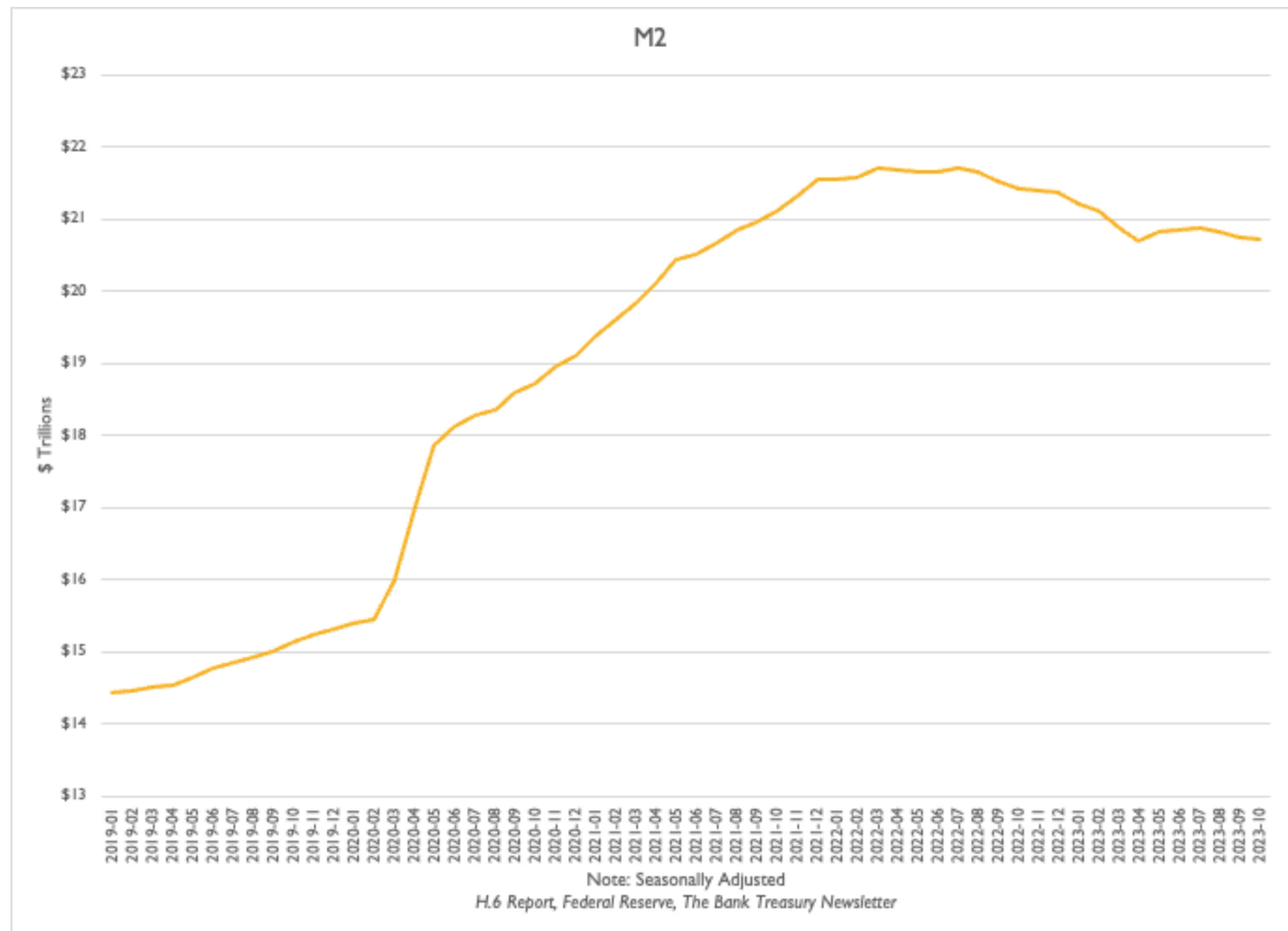
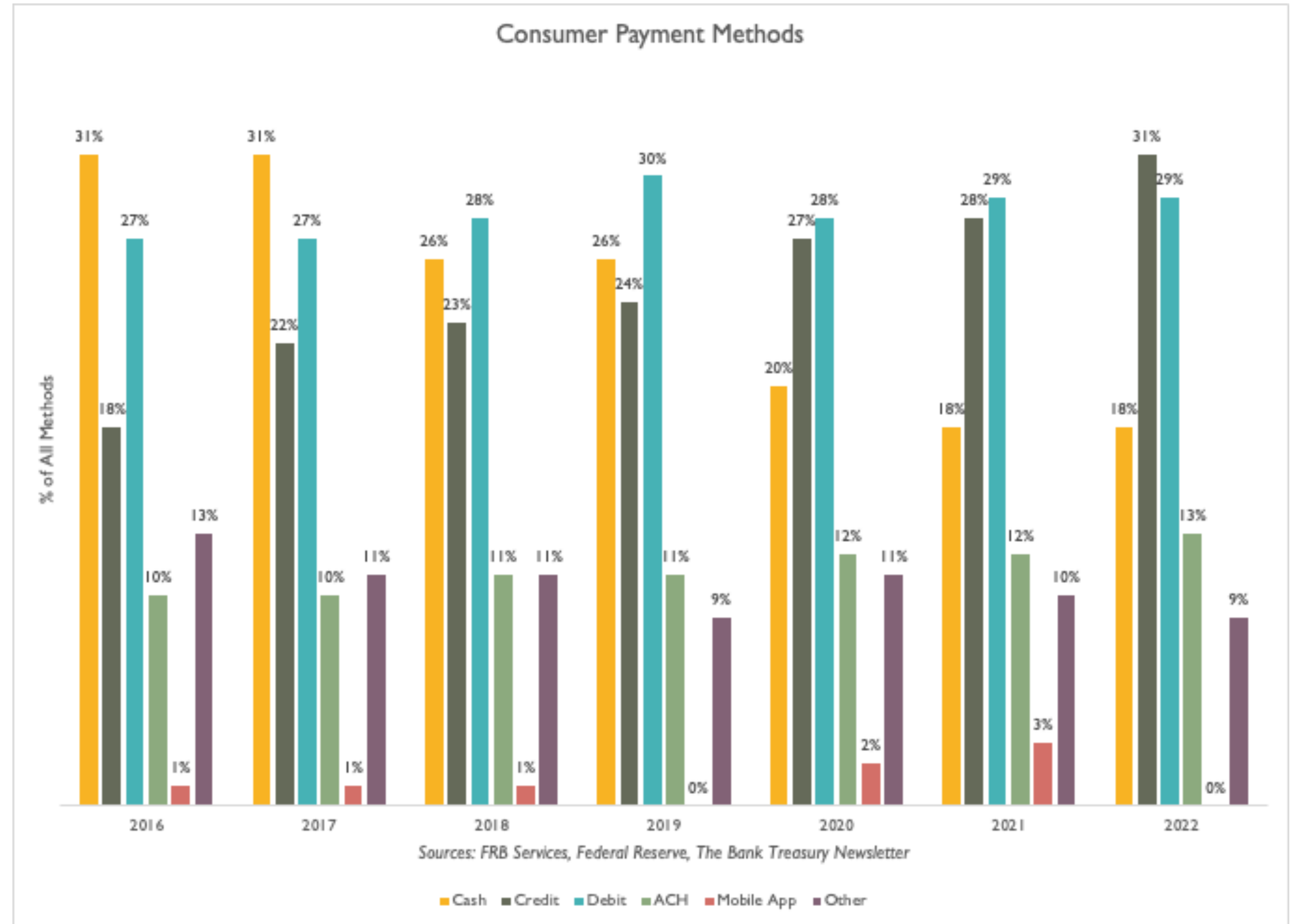
M2 Trends Flatten Since Last May

Even as the Fed reduced the total size of its balance sheet by $0.8 trillion since the beginning of last May, to $7.7 trillion this month, M2 was unchanged, at $20.8 trillion. Thus, almost all the money supply that was created through QE and Federal stimulus remains in the economy either sitting in bank deposits or money market funds.



Consumers Prefer Cards

In the early days of Covid, consumers began to use mobile payment Apps to pay for purchases, but use of that slowed in 2022. The main story in the consumer payment world is that consumers are using more credit cards and less cash. The only demographic that significantly relies on cash for their payment needs is the underbanked and unbanked according to a 2023 analysis by the Fed's payment system division.



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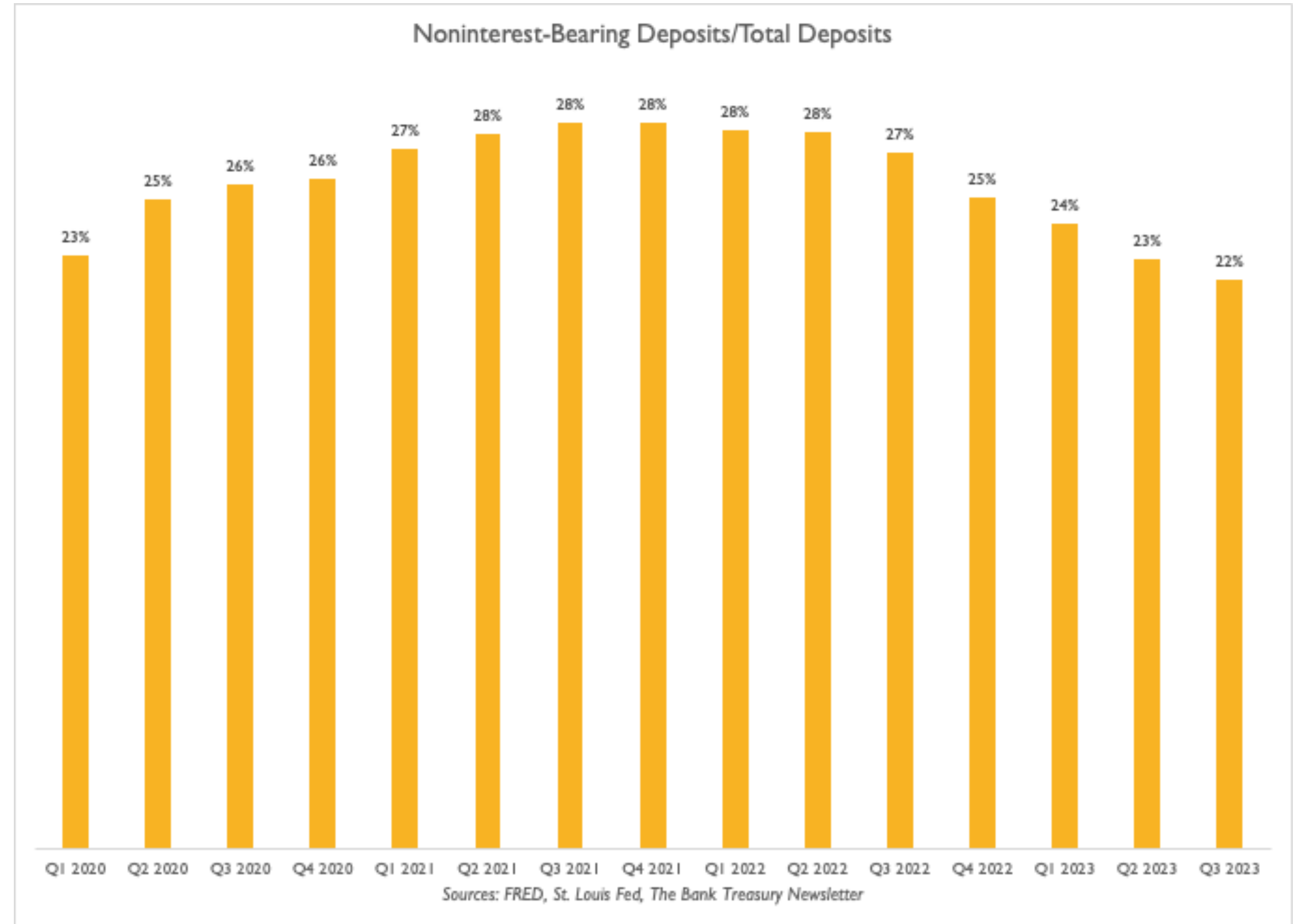
Savers Shift Out Of Interest-Bearing Deposits

Bank treasurers have struggled to predict the path for NIM next year as deposit behavior in the current rate environment has been difficult to gauge and the level of noninterest-bearing deposits plays such an important role in the projection. While the level of noninterest-bearing deposits are back to pre-Covid levels, banks report that consumers still prefer to hold higher checking balances than they did pre-Covid. On the other hand, they are also spending more because of inflation.



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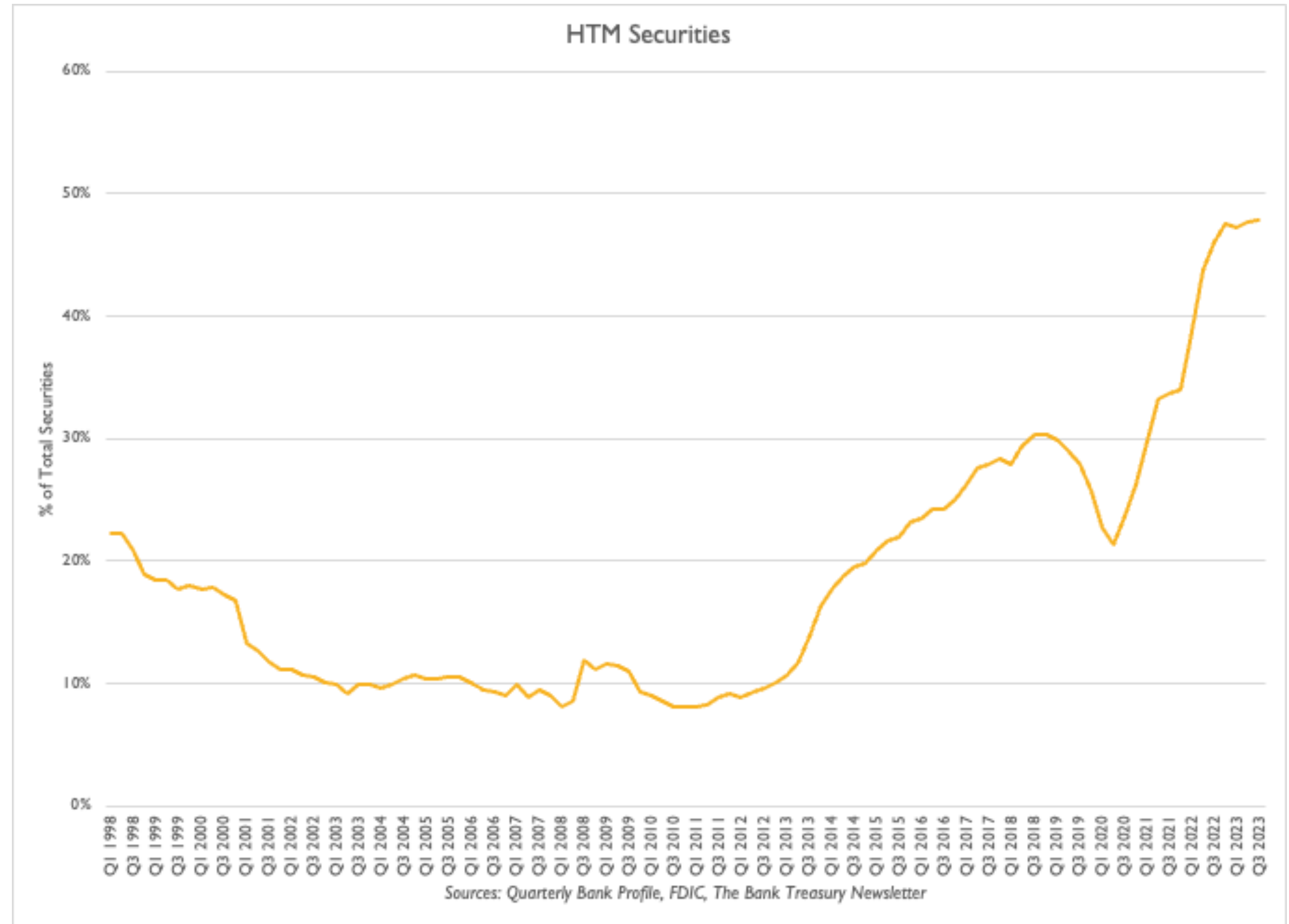
Almost Half The Bond Portfolio Locked Up In HTM

In the case of SVB, uninsured depositors ignored the presumption that it was a going concern, presumably looking through the HTM accounting that let it shield most of its bond portfolio from fair value and appear solvent.



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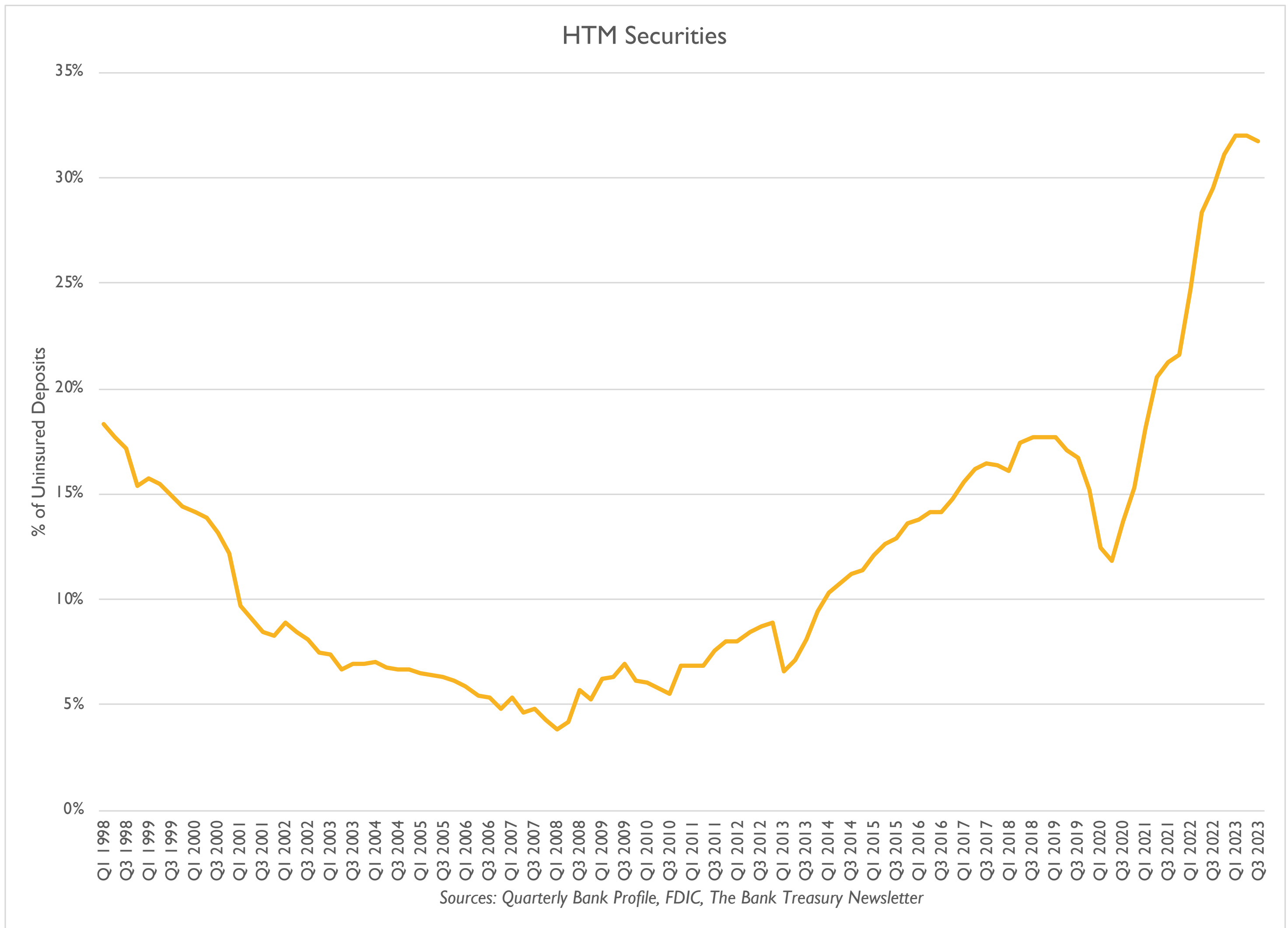
Uninsured Deposits Support More Illiquid Bonds

Uninsured deposits shot up from $7.7 trillion when Covid began to peak at $9.8 trillion in March 2022 and then fell just as precipitously since then to $8 trillion by September 2023. Meanwhile, securities in HTM increased from $1.0 trillion to $2.5 trillion.



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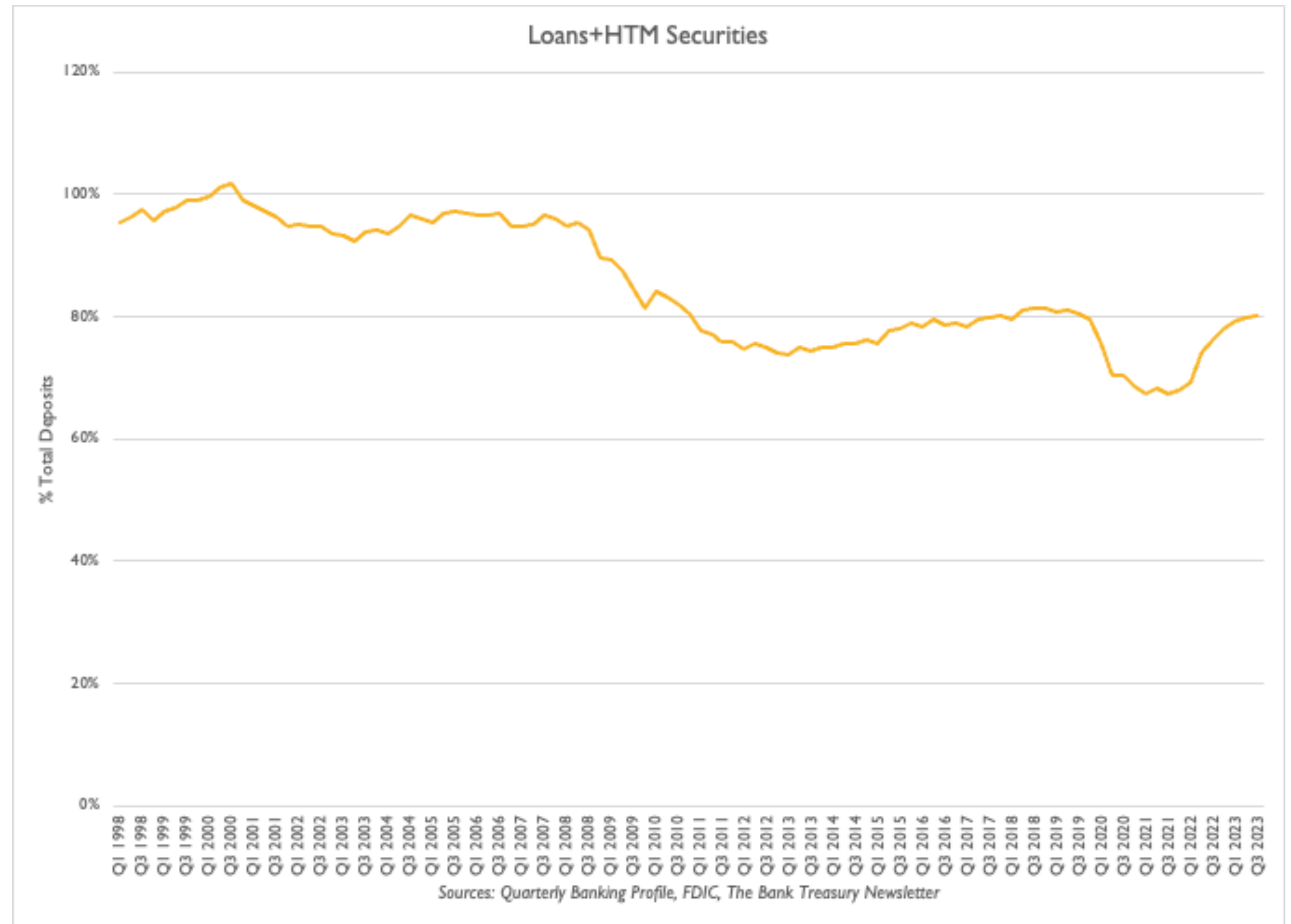
Balance Sheet Liquidity Back To Pre-Covid Levels

Although bank balances sit on more securities today than they did before Covid, when the ratio of loans to deposits is adjusted to include HTM, balance sheets appear to be back to the same level of broad liquidity they had going into the pandemic.



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